



Country Program Evaluation

Nicaragua

2013-2017

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Preface

As part of its 2017-2018 annual work plan, the Office of Evaluation and Oversight (OVE) prepared this country program evaluation (CPE) with Nicaragua for the period 2013-2017. This is the fourth time that OVE is evaluating the Inter-American Development Bank's program with Nicaragua. The previous evaluations covered the periods 1991-2001 (document RE-272), 2002-2007 (document RE-344), and 2008-2012 (document RE-422).

CPEs serve as inputs for preparing the IDB Group country strategies.¹ CPEs seek to “provide information on Bank performance at the country level that is credible and useful, and that enables the incorporation of lessons and recommendations that can be used to improve the development effectiveness of the Bank's [...] strategy and program [with a] country.”² Now that the Inter-American Investment Corporation (IIC)—now IDB Invest—has assumed responsibility for the non-sovereign guaranteed activities of the IDB Group, the CPEs also cover IDB Invest activities.

This CPE will contribute to preparation of the IDB Group's new country strategy, which will replace the current strategy (document GN-2683, 2012). The CPE brings an independent vision to an analysis of the IDB Group's working relationship with the country, particularly its relevance, effectiveness, efficiency, and sustainability. The evaluation, which covers the financial and nonfinancial products offered by the IDB Group during the period 2013-2017, focuses on assessing the achievement of the proposed objectives and extracting lessons learned that can be useful for the future strategy.

The evaluation gathered and compared information from diverse sources. These sources included interviews with key informants: current and former officials in Nicaragua, members of project executing agencies, IDB Group sector specialists, international donors, and members of academia and civil society familiar with the country's development challenges and the various sectors in which the Bank operates. In addition, OVE analyzed the Bank's programming documents (country development challenges -CDC; country program document -CPD, country strategy-, supervision documents -progress monitoring report, PMR-; project supervision

1 The IDB Group includes the Inter-American Development Bank and the Inter-American Investment Corporation, now IDB Invest.

2 Protocol for Country Program Evaluations (document RE-348-3).

report -PSR-; annual supervision report -ASR-), and evaluation documents (project completion report -PCR-; expanded project supervision report -XPSR-; expanded supervision report -XSR-). OVE supplemented this documentary analysis with an analysis of internal and external databases.

The result is this report, which is divided into four chapters. Chapter I examines the country context in which the IDB Group program was carried out. Chapter II analyzes the relevance and efficiency of the IDB country strategy with Nicaragua and the resulting program. Chapter III assesses the relevance, effectiveness, and sustainability of the projects supported by the IDB Group in each of the strategic sectors and dialogue areas, as well as their potential contribution to the achievement of the development objectives identified in the country strategy. Lastly, Chapter IV sets out conclusions and recommendations based on the preceding analysis.

Acknowledgements

This document was prepared by the project team consisting of: Alejandro Soriano, María Fernanda Rodrigo López, Nadia Ramírez Abarca, Nathaniel Russell, María José Hernández, and Melanie Putic, directed initially by Cheryl Gray and Monika Huppi and subsequently by Pablo Alonso. We are grateful to IDB Management and to the Government of Nicaragua for their support and cooperation in this evaluation process.

Acronyms and Abbreviations

AECID	Agencia Española de Cooperación Internacional para el Desarrollo [Spanish Agency for International Development Cooperation]
BCN	Central Bank of Nicaragua
BFP	Banco de Fomento de la Producción [Production Development Bank]
CABEI	Central American Bank for Economic Integration
CAFTA-DR	Central American Free Trade Agreement - Dominican Republic
CDC	Country Development Challenges
CIAT	Centro Interamericano de Administraciones Tributarias [Inter-American Center for Tax Administrations]
CICO	Centros Infantiles Comunitarios [Community Children's Centers]
COSEP	Consejo Superior de la Empresa Privada [Private Enterprise Council]
COSUDE	Swiss Agency for Development and Cooperation
CPE	Country Program Evaluation
DGA	Dirección General de Aduanas [Customs Administration]
DGI	Dirección General de Ingresos [Revenue Service]
ECLAC	Economic Commission for Latin America and the Caribbean
EIB	European Investment Bank
EMNV	Encuesta de Medición de Nivel de Vida [Living Standards Survey]
ENACAL	Empresa Nicaragüense de Acueductos y Alcantarillados [Nicaraguan Water and Sewer Company]
ENATREL	Empresa Nacional de Transmisión Eléctrica [National Power Transmission Company]
ENEL	Empresa Nicaragüense de Electricidad [Nicaraguan Electricity Company]

FDI	Foreign Direct Investment
FELABAN	Federación Latinoamericana de Bancos [Federation of Latin American Banks]
FOMAV	Fondo de Mantenimiento Vial [Road Maintenance Fund]
FSO	Fund for Special Operations
FUNIDES	Fundación Nicaragüense para el Desarrollo Económico y Social [Nicaraguan Foundation for Economic and Social Development]
GDP	Gross Domestic Product
IMF	International Monetary Fund
INIDE	Instituto Nacional de Información de Desarrollo [National Institute for Development Information]
INSS	Instituto Nicaragüense de Seguridad Social [Nicaraguan Social Security Institute]
INVUR	Instituto Nicaragüense de la Vivienda Urbana y Rural [Nicaraguan Urban and Rural Housing Institute]
LAC	Latin America and the Caribbean
MFI	Microfinance Institution
MSMEs	Micro, Small, and Medium-sized Enterprises
NFPS	Nonfinancial Public Sector
NGO	Nongovernmental Organization
NICA Act	Nicaraguan Investment Conditionality Act
NSG	Non-Sovereign Guaranteed
OECD	Organization for Economic Cooperation and Development
OVE	Office of Evaluation and Oversight
PBL	Programmatic policy-Based Loan
PNDH	Plan Nacional de Desarrollo Humano [National Human Development Plan]
PPP	Public-private partnership
PREAL	Programa Promoción de Reforma Educativa en América Latina y el Caribe [Program for Promotion of Educational Reform in Latin America and the Caribbean]
SG	Sovereign guaranteed
SMEs	Small and medium-sized enterprises
UNDP	United Nations Development Programme
UNESCO	United Nations Educational, Scientific, and Cultural Organization
USEIA	U.S. Energy Information Administration
WEF	World Economic Forum
WEO	World Economic Outlook

Executive Summary

Nicaragua is a lower-middle-income country that, while having experienced sustained growth, has a low-value-added productive structure skewed toward the Pacific coast. Service sectors account for 57% of GDP, while the major export sectors, such as agriculture and the maquila industry operating in free trade zones, have provided less value added. The population is unequally distributed, particularly on the Caribbean coast, which is home to just 14% of the population and has limited infrastructure. Between 2012 and 2017, the GDP growth rate averaged 5%, topping the average for Latin America (2.3%). Growth was driven by consumer spending and exports (benefiting from favorable external demand and prices). In turn, this growth brought about improvements in the poverty and inequality rates. Despite this, Nicaragua's GDP per capita is the third lowest in Latin America and the Caribbean.

Fiscal discipline enabled a consolidation of public finances, but medium-term risks persist. The public debt was reduced (from 53% to 47% of GDP between 2012 and 2017), and the central administration deficit went from a surplus of 0.5% of GDP in 2012 to a deficit of 0.6% of GDP in 2017. However, the nonfinancial public sector (NFPS) deficit has increased under the financial pressure exerted by the social security system and most public utilities. Moreover, the external sector reflects the vulnerability of the economy, since a single country—the United States—absorbs 40% of Nicaraguan exports. Discussion of the Nicaraguan Investment Conditionality Act (NICA Act) in the United States Congress, coupled with the situation in Venezuela, adds uncertainty to a portion of the country's external financing and could result in a reduction in foreign direct investment (FDI).¹

Nicaragua's development model faces challenges in the transition to a value-added economy and economies of scale. Agricultural production in Nicaragua is low-pay, labor-intensive, and unsophisticated, marked by precarious land tenure and low technology. Productivity has been stagnant due to limited modernization, barriers in access to credit and inputs, and inadequate value chains, market development, and economies of scale. The largest contribution to growth has come from the manufacturing sector, but productivity gains are due to an increase in value added per worker rather than to labor shifts to other sectors. Light manufacturing has become one of the country's

¹ Since 2008, Nicaragua has been receiving FDI from Venezuela and loans under the Petrocaribe cooperation arrangement, and these funds are used to finance social and capital spending.

largest industries, although it faces challenges such as a lack of value added and limited diversification (World Bank, 2017). The tourism sector's positioning is still weak, tourism offerings are relatively inconsistent, and average income continues to be low.

Despite progress, there are gaps in the supply of infrastructure and access to services that affect competitiveness. In the energy sector, certain areas have limited coverage and continue to be heavily dependent on fossil fuels (47.9%), making the country vulnerable to changes in international oil prices. In the transportation sector, road network coverage is low, with problems of quality and low connectivity on the Atlantic coast. Road maintenance resources are insufficient. Port infrastructure is also insufficient, and facilities are inadequate. The water and sanitation sector faces persistent challenges in terms of quality and coverage of services for the population, especially in rural areas. Furthermore, credit is targeted to large business groups and the consumer segment.

Deficiencies in human capital, in terms of both educational and health standards, continue to limit productivity. Educational levels are among the lowest in the region, with problems of quality and employment. Despite having increased, preschool, primary school, and secondary school attendance rates are below the Latin America and Caribbean average, with significant urban-rural disparities. The dropout rate in the second cycle of secondary school is among the highest in Latin America and the Caribbean. Furthermore, education infrastructure faces challenges, and teachers are poorly trained, hindering improvements in the quality of education. In the health sector, while maternal mortality has been reduced by half and universal immunization coverage for children under the age of one was achieved in 2014, the infant mortality, under-five mortality, chronic malnutrition, and adolescent pregnancy rates remain high and exhibit regional disparities.

During the evaluation period, the Bank continued to be Nicaragua's most important multilateral partner and succeeded in joining the policy dialogue in key sectors. The IDB Country Strategy with Nicaragua 2013-2017 was relevant because it was aligned with the Nicaraguan government's National Human Development Plan 2012-2016 (PNDH). During this period, the Bank approved US\$1.339 billion in loans, investment grants, and technical cooperation operations, exceeding the level of approvals set out in the lending framework for the country strategy and amounting to an increase of 43% with respect to the prior period. This higher financing level was partly due to a change in the proportion of soft lending resources from the Fund for Special Operations (FSO). The loan portfolio was heavily concentrated in the energy, transportation, and health sectors. In addition, it grew in relevance because it focused on expanding the supply of electricity and health services in areas with low coverage, as well as on linking rural centers of production with the

major corridors and border crossings. The private sector portfolio contracted during the evaluation period but increased its share in operations that channel funds through financial institutions. Lastly, technical cooperation resources were mainly used to strengthen the institutional capacity of State agencies.

The Bank's operations program showed a preference for programmatic and sequential operations. Very similarly to the breakdown in the previous country strategy period, 70% of the amount approved through the public window was for investment loans (14 operations, US\$942 million), while 20% was for policy-based programmatic loans (PBLs) (5 operations, US\$285 million), and the rest went for investment grants (9 operations,² US\$90.08 million) and technical cooperation projects (60 operations, US\$22 million). In addition, almost half (41%) of the amount approved for sovereign guaranteed (SG) operations corresponded to programmatic/sequential operations, with 20% for a sequential program in transportation (three operations, US\$269.2 million), 13% for three PBLs in energy (US\$175 million), and 8% for two PBLs in competitiveness (US\$110 million). This highlights the Bank's long-term vision in the priority sectors.

Net flows were positive for Nicaragua throughout the period. Loan disbursements rose 32% with respect to the prior period (2008-2012). Net flows were positive for the country, peaking in 2017 due to a disbursement of US\$130 million under the third energy related PBL and the second competitiveness-related PBL. Nevertheless, 63% of the increase in disbursements during the period is the result of higher disbursements under investment loans, half of them being disbursements of SG loans approved during the period under evaluation. The main factors underlying these fast disbursements include the focus on programmatic and sequential operations.

The Bank's operations program in Nicaragua showed a concentration in infrastructure and relative continuity with respect to the previous strategy. In the last decade, the Bank focused on civil-works-intensive sectors such as transportation, energy, and health, targeting building infrastructure issues to expand the supply of services in areas with greater disparity. In fact, 74% of the resources for new SG operations went to physical works,³ transportation being one of the sectors that allocated the most resources to infrastructure (80% of SG resources). At the same time, the continuity of strategic pillars made it possible to integrate the legacy portfolio, concentrated in energy, transportation, and health, into the new country strategy while reflecting the Bank's medium- and long-term relationship with Nicaragua in these sectors.

2 This amount includes two contingent grants: NI-G1006 and NI-G1007.

3 42% in transportation and communications, 24% in health, 19% in energy, 9% in water and sanitation, and 6% in others.

There were significant advances in productive infrastructure in the priority sectors of the country strategy, but the sustainability of the investments continues to be a challenge. The Bank played a central role in the improvement of infrastructure, particularly in the energy sector and with the connectivity of the Pacific-Atlantic corridor. However, long-term sustainability risks persist. For example, the absence of an operating budget for the Road Maintenance Fund (FOMAV) would jeopardize the operational road network, as well as maintenance of the water and sanitation works, areas in which the Bank has helped to finance investments. This pattern is repeated with services such as those launched through the health and early childhood programs, which are at risk of being discontinued due to lack of space in the national budget.

The Bank allocated fewer resources to public and fiscal management than in the previous period, although doing otherwise would have been relevant to improving the fiscal space and making program-financed investments sustainable. Public administration issues became less relevant than in the previous country strategy. The Bank approved about US\$16 million in technical cooperation resources, which strengthened the institutional capacity of various government agencies. This stands in contrast to the importance given to these issues in the National Human Development Plan (PNHD), in OVE's country program evaluation with Nicaragua for the period 2008-2012 (document RE-422-3), and in the discussion on key barriers to development in the current country strategy. The foregoing is relevant, since the sustainability of the works and services financed through the program depends on factors that include institutional capacity, expenditure targeting, and adjustments in the sector frameworks.

The Bank's program in the productive sector was relevant because it set in motion major financial and institutional reforms, but these reforms have not yet succeeded in creating a critical mass in sectors with the potential to generate greater value added. Actions in value chains were focused on two PBLs, primarily related to financial and institutional reforms, as well as on isolated operations approved prior to 2013. While the policy conditions of the PBLs constitute important steps toward improving the regulatory environment for doing business and enhancing financial inclusion, a government commitment is needed to develop a critical mass in sectors in which the country could provide greater value added.

The private sector portfolio supported relevant sectors but contracted by 12% and showed limited financial additionality. Thus, it reflected the need to explore potential support through public-private partnerships (PPPs), as had been suggested in the previous country strategy. Direct corporate lending to SMEs and large companies shrank by 45% with respect to the prior period, reflecting access to alternative sources of financing on the part of clients of IDB Invest. In addition, loans

channeled through financial intermediaries supported the real sector of the economy and offered similar maturities to those available in the market but promoted financial inclusion by serving small and medium-sized producers. Moreover, IDB Invest performed a thorough analysis of potential opportunities in Nicaragua, concluding that PPP opportunities are available if they are developed in the context of adequate rate structures for the country.

Recommendations

In view of the preceding conclusions, OVE recommends that Management should consider a proposal to the country to continue working to lock in the remarkable progress that has been made in the country's development. It should be noted that the country and the Bank have been working on the five key areas with varying degrees of emphasis and coverage, subject to the recommendations set out below. Therefore, OVE recommends continuing to work on these areas given their importance in a process of balanced IDB Group support to the country's development. In fact, significant strides have been made and, in the judgment of OVE, they should be continued in the Bank's future strategy with Nicaragua. Lastly, whether the IDB Group plays a greater or lesser role in supporting each area will be subject to the country's preference and demand. Consequently, the IDB Group's action plan may only outline its proposals for supporting the country.

OVE recommends that the IDB Group should offer the country clear continuity of support in five key areas of work. The first two areas of work are aimed at strengthening the project cycle, both at the front end (preinvestment and execution capacity) and at the back end (sustainability). The third recommendation is aimed at restoring the centrality of the dialogue on the efficiency of public expenditure to help the country expand its fiscal space sufficiently to sustain an ambitious investment program. The fourth recommendation is aimed at supporting the country in its long-term investment planning process through a territorial approach designed to resolve infrastructure bottlenecks that limit competitiveness. The final recommendation suggests that the IDB Group should redouble its efforts to support the country in promoting competitiveness and value added in key sectors in which it could have comparative advantages.

- **Recommendation 1 - Preinvestment and implementation capacity: Continue to support the country in the stages of preinvestment and capacity-building for the execution of operations.** In view of the challenges evident in the preinvestment and implementation stages, OVE recommends that the IDB Group should support both the preparation of detailed designs for investment projects and capacity-building at the executing

agencies. In addition, as part of the project design process, it should evaluate the execution capacity of agencies that are not specialized in the management of civil works.

- **Recommendation 2 - Sustainability of investments: Continue to work with the country to identify and promote mechanisms to improve the sustainability of works and services financed by the IDB Group.** OVE recommends that the loan proposals should identify sustainability risks and thoroughly analyze potential mitigation measures to optimize the continuity of operation and maintenance of program outputs (infrastructure works and services).
- **Recommendation 3 - Fiscal management: Deepen the dialogue and intensify financial support for the government to improve fiscal space, including the efficiency of spending, with a view to optimizing the sustainability of the country's public investment.** OVE recommends that the Bank should propose to the country efforts to tackle the structural elements on both the revenue and fiscal spending sides that limit the country's capacity to meet its public investment challenges. The Bank's support should be aimed at improving the country's fiscal capacity to sustain public investment in the medium and long term. In turn, to guide these reforms, OVE recommends supporting the country in strengthening its fiscal management tools, including its monitoring and evaluation systems for investment projects.
- **Recommendation 4 - Comprehensive planning: Continue to support the country in identifying medium- and long-term investments.** OVE recommends that the IDB Group should continue to support the country in building its medium- and long-term comprehensive planning capacity, including territorial aspects to help prioritize investments in the various types of physical infrastructure and services that can spur the country's development.
- **Recommendation 5 - Competitiveness and value added: Continue the IDB Group's support in developing the country's competitiveness by furthering reforms to improve the business climate and increasing the value added of supply chains in which Nicaragua could have comparative advantages.** OVE recommends that the IDB Group should continue to provide support, acting through its public and private windows, to improve the business climate and expand the supply of production inputs that will enhance value added in sectors in which Nicaragua has comparative advantages. In addition, OVE recommends that IDB Invest should provide support in public-private partnerships.



01

Context of the Country Program

- 1.1 Nicaragua has the third-lowest per capita GDP in Latin America and the Caribbean. With per capita income, measured at purchasing power parity, of US\$5,823 (2017), Nicaragua is below the average for Latin America and the Caribbean (US\$14,400 according to the IMF, WEO) and above only Haiti and Honduras. Service-related sectors account for the greatest share of GDP, averaging 57% in the 2012-2017 period (including commerce at 11%, residential real estate at 6%, and transportation and communications at 5%), while sectors such as agriculture, timber, fishing, and mining averaged 19% of GDP in 2012-2017 and manufacturing averaged 14% of GDP in the same period. The country's productive structure did not undergo any significant changes over the last decade and faces challenges in achieving value added and scale.
- 1.2 The Nicaraguan population continues to be highly rural and geographically concentrated.¹ With 6.3 million inhabitants, Nicaragua has a population of similar size to that of El Salvador in Latin America and the Caribbean and Denmark in the developed world. A full 41% of the population lives in rural areas, compared with 20% in Latin America and the Caribbean.² The population is concentrated on the Pacific coast (52%) and central regions, while the Caribbean coast region is home to just 14% of the country's inhabitants.

A. Macroeconomic and institutional context

- 1.3 Nicaragua experienced sustained growth, spurred by prudent macroeconomic policies and a favorable external context, but it is exposed to vulnerabilities. In the 2012-2017 period,³ the economy grew at an average annual rate of 5.0%, the second-highest rate in Central America after Panama (6.3%) and more than twice the average for Latin America and the Caribbean (2.3%). This growth was spurred by policies conducive to price stability and fiscal sustainability, consumer spending (Figure 1.1), commodity and textile exports⁴ to the United States in the framework of trade treaties (CAFTA-DR),⁵ and favorable

1 Central Bank of Nicaragua (BCN) (2017). Nicaragua in figures 2016. Managua, Nicaragua.

2 However, the Managua metropolitan area has experienced sustained growth, concentrating nearly one third of the country's population and an ever-expanding urban fringe (Sustainable Managua Action Plan, 2014).

3 In the 2007-2011 period, the average annual rate was 3.2% (IMF, WEO).

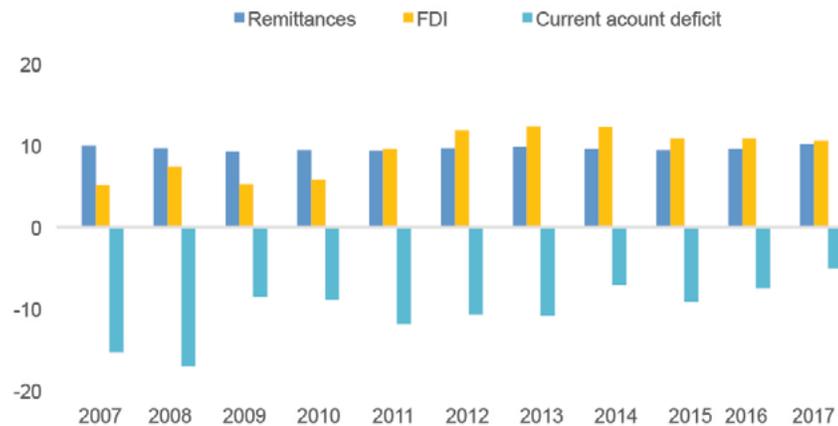
4 In 2017, agricultural, fishing, and mining products accounted for more than 75% of FOB merchandise exports (without considering the free trade zones), while textile products accounted for 63% of free trade zone exports (BCN, 2017b, Annual Report).

5 Central America-Dominican Republic Free Trade Agreement between the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic.

external demand and prices.⁶ Despite having reduced its current account deficit (8.4% of GDP in 2012-2017 versus 12.3% of GDP in 2007-2011),⁷ this deficit continues to pose a challenge for the country. Greater fiscal discipline and improved citizen security have led to a rise in foreign direct investment (FDI) revenue, from 6.6% of GDP in the 2007-2011 period to 11.5% of GDP in the 2012-2017 period,⁸ helping to finance the external deficit.

Figure 1.1
External sector
(% of GDP)

Source: BCN



1.4 Strong fiscal discipline led to a consolidation of public finances, but there are persistent medium-term risks. The country's economic growth allowed public debt to decline from 53% to 47% of GDP between 2012 and 2017.⁹ The central administration deficit went from a surplus of 0.5% of GDP in 2012 to a deficit of 0.6% in 2017.¹⁰ However, the nonfinancial public sector (NFPS) deficit faces financial pressure from the Nicaraguan Social Security Institute (INSS), the Nicaraguan Electricity Company (ENEL), the National Power Transmission Company (ENATREL), and the Nicaraguan Water and Sewer Company (ENACAL) (Figure 1.2). In addition, while the collaboration arrangement with Venezuela (Petrocaribe) is recorded as private debt, it could result in contingent liabilities.¹¹ Discussion of the Nicaraguan Investment Conditionality Act (NICA Act) in the United States Congress adds a measure of uncertainty over part of the country's external financing. These

6 In 2012-2016, remittances represented 9.6% of GDP and exports of goods and services represented 43.3%, as compared to 9.5% and 37.4% of GDP, respectively, in 2007-2011 (BCN, World Bank, WDI).

7 However, the drop in international oil prices made it possible to lower the oil bill from US\$1.145 billion in 2014 to US\$690 million in 2016 (BCN 2016).

8 FDI primarily targeted the manufacturing and telecommunications industries (BCN).

9 Debt forgiveness and an upward revision of the nominal GDP in 2012 —which turned out to be 30% higher due to the publication of national accounts with 2006 as the base year— were additional factors in the decline.

10 On average, it was 0.25% of GDP in 2012-2017 versus 0.5% of GDP in 2007-2011.

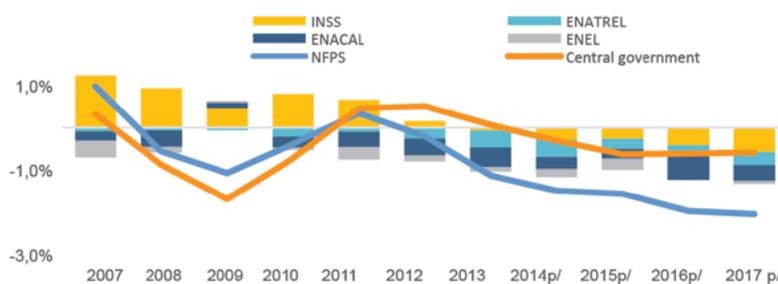
11 Since 2008, the country been receiving FDI from Venezuela and loans under the Petrocaribe cooperation arrangement, and these funds are used to finance off-budget social and capital expenditures; social spending accounts for roughly one third of the loans received (Moody's, July 2017).

factors highlight the prudent management of public finances, while underscoring the risks in terms of both fiscal revenue and the quality and efficiency of expenditure:

- **On the revenue side**, despite the increase in tax collection,¹² the levels of tax evasion, informality, and expenditure are high¹³ and taxes have little redistributive impact.¹⁴ There is still room for simplifying the transactional burden on taxpayers to meet their tax obligations.¹⁵
- **On the expenditure side**, there are rigidities in the composition of this activity. Current expenditure continues to account for the greatest share of total spending (75% in 2016, compared with 64% in 2007) despite increases in capital expenditure.¹⁶ In addition, social expenditure is fragmented and poorly targeted,¹⁷ and there are persistent weaknesses in the implementation of results-based budgeting and monitoring and evaluation systems.¹⁸

Figure 1.2
Fiscal sector balance
(% of GDP)

Source: BCN and IMF



1.5 The country and its productive sector are heavily affected by climate vulnerability despite progress in risk management. In the 1996-2015 period, Nicaragua was fourth on the list of the

12 From 2007-2011 to 2012-2015, it went from 17.6% to 20.2% of GDP. Over the same period, the average for Central America went from 18.1% to 19.2% of GDP (OECD/ECLAC/CIAT/IDB, 2017).

13 VAT evasion was 33% in 2013 (ECLAC/AECID, 2017), while corporate income tax evasion was 52% in the 2000-2010 period (Pecho, M. et al., 2012). Informality levels stood at 88% in 2015 (Funides, 2016), and the tax expenditure was 7.6% of GDP in 2010 (Pecho, M. et al., 2012). The tax expenditure exceeds the average for Latin America and the Caribbean (4.1% of GDP), Costa Rica (6.3% of GDP), and Panama (1.8% of GDP).

14 OVE, 2017. Approach Paper: Review of IDB Support to Tax Policy and Administration, 2007-2016 (document RE-509-1).

15 Average tax compliance requires 42 payments and takes up 201 hours (World Bank Group, 2017).

16 Between 2012 and 2017, capital expenditure went from 5.3% to 7.0% of GDP (IMF, Article IV 2017).

17 Between 56.3% and 97.6% of the beneficiaries of social interventions in 2014 were classified as not poor based on a poverty line of US\$1.8 per day per person (FUNIDES, 2017).

18 Cuestas, et al., 2015. *Construyendo Gobiernos Efectivos: Nicaragua*. IDB.

world's countries most affected by meteorological phenomena, after Honduras, Myanmar, and Haiti.¹⁹ The country made strides in natural resource management and risk mitigation, but production continues to be highly exposed to climate change. For example, it is estimated that in the absence of any climate change adaptation measures, the economic losses in agricultural production stemming from climate change would be equivalent to roughly 22% of GDP in 2100.²⁰

- 1.6 The real economy's productivity has stagnated and is marked by limited value added and poor access to input and service markets. For example, the agricultural sector is intensive in the use of unskilled labor²¹ and land with limited investment in infrastructure. Agriculture was the least productive sector in 2005 and 2014 (Funides, 2016b) and has stagnated due to low technical enhancement, precarious land tenure, barriers in access to credit and inputs, and insufficient economies of scale for the development of value chains. The country has made progress in agricultural certification and traceability, but export prices remain low. In addition, the sector's seasonality, coupled with the lack of storage and cold chain systems, stand in the way of a more profitable output.
- 1.7 Nicaragua has notable natural advantages but is only beginning to harness them, and there is a lack of large-scale works with long-term planning. For example, Nicaragua is one of the richest countries in water resources in Central America, but access to irrigation is scarce and costly. Barely 5.5% of agricultural land has access to irrigation.²² Nicaragua has both dry areas and sizeable bodies of water but harvesting them sustainably would require engineering works. Most of its low-irrigation land relies on localized pumping rather than on master plans, impacting production costs and reducing competitiveness.²³
- 1.8 Emerging sectors such as manufacturing improved their productivity but continue to face challenges related to value added. The manufacturing industry attracted the most FDI (31% in 2016) and contributed to formal employment²⁴ (19% in 2016). While manufacturing productivity increased, this was not due to labor shifts to other sectors but rather to a rise in value added per worker, which was generally the case in all sectors (Funides,

19 Global Climate Risk Index 2017, Germanwatch.

20 The estimates do not consider the farmers' potential adaptation to climate change or potential technological innovations (Ramirez, D. et al. 2010).

21 It employs about 30% of the work force and accounts for 68% of rural household income.

22 Zegarra E. and O. Chirinos, 2016. *Diagnóstico sobre la situación y potencial del sector riego en Nicaragua*, (IDB-TN-1063), IDB.

23 IDB, 2017. *Diseño de una estrategia de riego en Nicaragua: Diagnóstico sobre la situación y potencial del sector riego en Nicaragua* (part of operation NI-T1214).

24 Considers individuals affiliated with the INSS.

2016b). Meanwhile, light manufacturing, which operates primarily in free trade zones, has become one of the country's most important industries. Accounting for 12.3% of GDP and 40% of exports, it is the largest source of formal employment but faces challenges such as a lack of value added and few local supply chains (World Bank, 2017).

- 1.9 Nicaragua has not yet succeeded in promoting its high-potential sectors through a “country brand.” While the private sector has positioned Nicaraguan brands in products such as rum, coffee, and tobacco, this model has not been successfully replicated on a larger scale either in the agricultural sector or in other high-potential sectors. For example, in Latin America and the Caribbean, Nicaragua posted the third-highest growth in tourist arrivals, generating revenue equal to 5.3% of GDP and capital investment equal to 4% of GDP in 2017. Yet the country's tourism offerings are inconsistent and average revenue continues to be low, at about US\$381 per trip.²⁵ Generating higher revenue would require a country strategy aimed at tourists with more spending power and improvements in the basic service infrastructure, connectivity, and consolidation of various tourist hubs consistent with the demands of this market segment.
- 1.10 Despite major strides in coverage and renewable sources, the high cost of energy continues to be a drag on productivity. Between 2006 and 2016, the share of renewable energy grew from 30% to 52.1%²⁶ and service coverage went from 54% to 90.1%.²⁷ However, due to power purchase agreements entered into during periods of scarcity, cross-subsidies for the low-consumption residential sector, and high system losses, electricity rates for the high-consumption residential, industrial, and business segments are among the highest in the region (ECLAC, 2015).²⁸ The country continues to have high potential in terms of renewable resources, but conditions need to be developed to avoid pegging new long-term agreements to the high rates in effect at present and to complete the regional and local electric interconnection

25 Strategy for developing the tourism sector in Nicaragua, Global Advisory, 2017.

26 In 2016, wind power accounted for 15.9%, biomass 11.6%, geothermal power 15.4%, and hydro power 9.3% (INE).

27 There are still low-coverage areas. For example, in 2016, 49.5% of the total population of the North Caribbean Coast Autonomous Region (RACCN), 45.8% of the San Juan River region's total population, 42.2% of the total population of the South Caribbean Coast Autonomous Region (RACCS), and 40.3% of Jinotega's total population had no access to service (MEM).

28 The *Instituto Nicaragüense de Energía* [Nicaraguan Energy Institute] has records of 18 power purchase agreements, mostly negotiated around 2008, when oil was at a historic high, for a term of 25 years. Distribution losses exceed 22%, as compared to an OECD average of 6%. Lastly, residential consumers of up to 100kWh benefited from subsidized rates on the order of one third of the top residential and commercial rate and 43% of the industrial rate, which has turned out to be regressive due to the relatively high cutoff point.

in order to enable clean, lower-cost generators to compete.²⁹ Lastly, subsidies need to be streamlined and losses reduced in order to solidify sustainability.³⁰

- 1.11 There are widespread gaps in infrastructure, particularly in rural and periurban areas. Road coverage is low and unequally distributed, and there are problems with quality.³¹ Resources for road management are insufficient due to a lack of fuel surcharge adjustments and the absence of collection mechanisms to offset Nicaragua's status as a transit country in regional trade.³² The international logistics situation faces challenges and the port infrastructure is insufficient and facilities are inadequate.³³ The case of water and sanitation coverage is similar, with persistent challenges in terms of quality and coverage, especially in rural areas³⁴ (Figure 1.3). With the development of cities, this unequal access to services has also affected periurban areas, creating challenges such as in urban transportation.³⁵
- 1.12 Access to financing continues to be a key barrier to productive development. The national financial system is sound but relatively undeveloped.³⁶ Credit is targeted to large business groups and the consumer segment. Micro, small, and medium-sized enterprises (MSMEs), which account for 90% of all

29 Nicaragua is a member of the *Sistema de Interconexión Eléctrica de los Países de América Central* [Electrical Interconnection System for Central American Countries] (SIEPAC) but has purchased the least power through the system of any member (2.5% of the total). Domestically, Nicaragua has high-technical-risk geothermal projects as well as hydropower projects (for example, Tumarín, which at 253MW would be the country's largest dam and provides greater technical certainty but has suffered delays due to financial problems with the original concession-holder).

30 In 2018, reforms were approved in the system of subsidies that will gradually reduce subsidies up to 2022 but will not entirely eliminate them. To date, subsidies are equivalent to 1.6% of GDP (World Bank).

31 In 2015, only 16% of the road infrastructure was paved and 29.5% of the roads were serviceable only in the dry season. In the departments of the Atlantic region, only 5% of the roads were paved and their density was nearly 10 times lower than in the Pacific and central regions (Ministry of Transportation and Infrastructure (MTI) July 2016). In contrast, there were improvements in the state of the trunk roads (from 27% in 2012 to 45% in 2017).

32 The Road Maintenance Fund (FOMAV) derives its revenue from a fuel surcharge of US\$0.16 per gallon, which has not been adjusted since 2009.

33 Border formalities take 72 hours to complete, while averaging 64 hours in Latin America and the Caribbean (40 hours in El Salvador and 24 hours in Panama) (World Bank, 2017). Nicaragua lacks an efficient deepwater port.

34 In 2014, 62% of the population was connected to the drinking water system (25% in rural areas). In 2015, 68% had access to improved sanitation facilities (56% in rural areas), while in Central America it was 78% (69% in rural areas) (World Bank, WDI, 2018 and WHO/UNICEF-JMP, 2017).

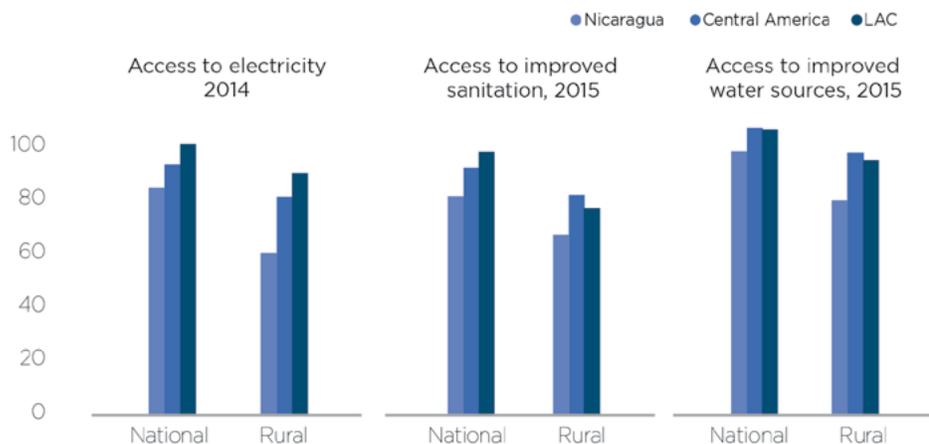
35 The Managua metropolitan area already concentrates more than one third of the country's population, yet it lacks transportation solutions such as rapid bus networks that can connect the areas in the urban periphery.

36 The three largest banks (out of seven) hold 77% of the assets in the system. In 2015, the deposit/GDP ratio was 41% and the credit/GDP ratio was 37%, among the lowest in Central America (Felaban, 2016).

businesses, have trouble obtaining bank loans.³⁷ One of the main restrictions is the requirement for security, which on average is double the loan amount. In addition, there is a phenomenon of self-exclusion from the financial system, wherein small and informal businesses choose to fund their operations using their own capital (COSEP/ILO, 2015).³⁸ This limits the growth of Nicaraguan businesses able to spur competition in sectors dominated by large corporate groups, which have ample access to financing.

Figure 1.3
Gaps in basic
services coverage
(% of the population)

Source: World Bank,
WDI



1.13 The institutional challenges and the regulatory framework limit the country's potential for development.³⁹ As reflected by the various indicators used to describe the governance and business climate conditions in countries, Nicaragua's public administration faces challenges in professionalizing the civil service⁴⁰ and in improving governance, regulatory quality, and accountability⁴¹ (Figure 1.4). In fact, businesses perceive bureaucratic inefficiencies and lack of legal certainty as the

37 Fifty-seven percent of businesses have trouble obtaining loans. In fact, two thirds of business loans are provided by cooperatives (which have not yet fully adopted the risk regulation rules) and microfinance institutions (MFIs) (regulated by the National Microfinance Commission (CONAMI)) (IMF, 2017 and COSEP/ILO, 2015). It should be noted that the Bank has supported CONAMI in adapting risk-based oversight manuals.

38 Fifty-one percent of enterprises stated that they had applied for loans to develop their business. The reasons cited for not having applied for a loan are lack of need (72% of formal enterprises and 49% of informal enterprises), followed by high interest rates (19% of formal enterprises and 29% of informal enterprises). In enterprises that did apply for a loan, the main obstacles were the number of requirements and a lack of sufficient security (COSEP/ILO, 2015).

39 Clear rules, incentives, and policies, as well as the ability to provide public goods efficiently, have effects on growth (Acemoglu and Robinson, 2008).

40 The IDB Civil Service Development Index (CSDI) for Nicaragua rose from 22 to 35 over the 2004-2015 period —although the development level continues to be low— due to the structuring of posts, updating of institutional manuals, gradual establishment of open competitions, accreditation of the civil service career, and innovations in information systems and performance evaluations.

41 For example, fiscal information is limited, unreliable, and incomplete (IBP, 2016; IMF, 2017).

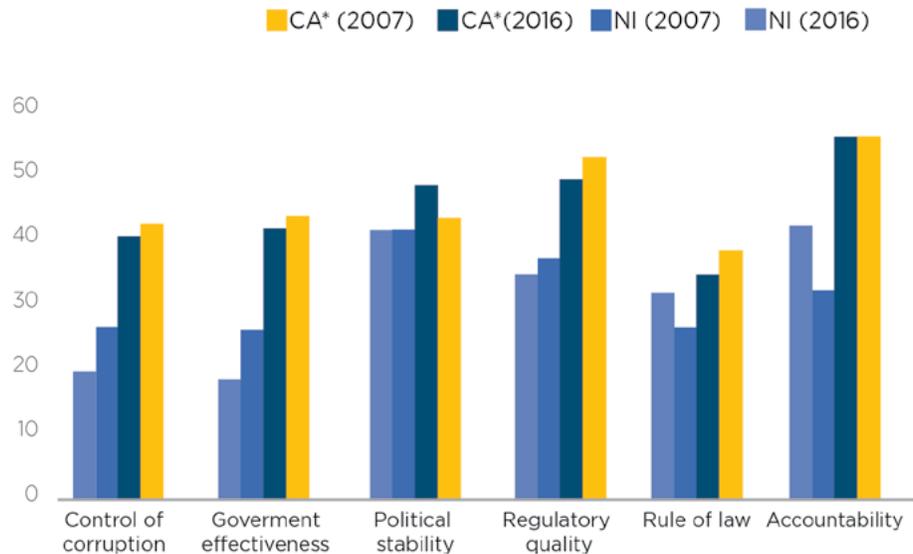
factors with the greatest impact on the business climate.⁴² Moreover, public information is difficult to obtain⁴³ and the production of data is deficient in terms of quality, frequency, and geographic disaggregation (World Bank, 2017).

Figure 1.4
External sector
Governance ranking

Source: World Bank Group,
Worldwide Governance
Indicators

CA: Central America;
NI: Nicaragua.

The graph shows the
country's ranking in
governance indicators, 0
being the lowest and 100 the
highest.



B. Social development and poverty reduction

1.14 Poverty and extreme poverty decreased but remain higher than the Latin America and Caribbean average.⁴⁴ The sustained economic growth helped reduce the poverty rates, but geographic disparities persist.⁴⁵ The country has the second lowest inequality level in Central America, but in a context in which its per capita GDP is the third lowest in Latin America and the Caribbean.⁴⁶ Lastly, Nicaragua's Human Development Index, while higher than those of Guatemala and Honduras⁴⁷, shows significant gaps in education, with average years of schooling (6.5) ahead of only Guatemala (6.3) and Honduras (6.2), and in health, with the highest levels of maternal mortality and adolescent pregnancy.

42 Encuesta Empresas Sostenibles Nicaragua [Sustainable Business Survey] (COSEP/ILO, 2015).

43 Nicaragua Freedom of the Press 2016 (Freedom House).

44 In the 2005-2016 period, poverty declined from 48.3% to 24.9% and extreme poverty declined from 17% to 6.9% (INIDE, based on EMNV 2016), while extreme poverty using income as a measure of welfare declined from 20.4% to 15.0% (Székely, 2016). In comparison, poverty by income and extreme poverty in Latin America and the Caribbean averaged 28% and 11.8% respectively in 2014 (ECLAC).

45 The poverty rates in the Caribbean coast are four times higher than in Managua (Székely, 2016).

46 The Gini coefficient declined from 49.2 to 46.6 in the 2005-2014 period; only El Salvador had a lower level (41.8 in 2014) (World Bank, December 2017).

47 Nicaragua is ranked 124th out of 188 countries, while Panama is ranked 60th, Costa Rica 66th, Belize 103rd, El Salvador 117th, Guatemala 125th, and Honduras 130th (UNDP, 2016).

- 1.15 Education levels are among the lowest in the region, with problems in terms of quality and employment. Despite having increased, preschool, primary school, and secondary school attendance rates are below the Latin America and Caribbean average, with significant urban-rural disparities.⁴⁸ The gross school attendance rate in the first cycle of secondary school has risen at the same pace as the regional average, but the dropout rate in the second cycle of secondary school is one of the highest in Latin America and the Caribbean (43%). In addition, infrastructure faces challenges, and teachers are poorly trained,⁴⁹ hindering improvements in the quality of education.⁵⁰ The low schooling and educational quality levels result in an unskilled labor force, which is one of the problems faced by companies doing business in the country.⁵¹ In addition, job market opportunities are scarce, leading to a high percentage of young people who neither study nor work (nearly 30% in the 18-31 age bracket, a proportion exceeded only by Honduras's 32%) (Székely, 2016).
- 1.16 The health sector has made significant achievements, but there are still gaps and regional disparities. Maternal mortality decreased by half⁵² and universal immunization coverage for infants under one was achieved in 2014. However, similar advances have not been made in areas such as infant mortality,⁵³ under-five mortality, chronic malnutrition,⁵⁴ and adolescent pregnancy,⁵⁵ where rates remain high and reflect significant regional disparities. In addition, services are limited. Hospitals

48 The country has an attendance rate of 63% in preschool (55% in rural areas), 87% in primary school (88% in rural areas), 43% in first-cycle secondary school, and 32% in second-cycle secondary school. By way of comparison, attendance rates in Latin America and the Caribbean are 84% for preschool, 95% for primary school, 62% for first-cycle secondary school, and 50% for second-cycle secondary school (Székely, 2016).

49 The Ministry of Education (MINED), *Consejo Nacional de Universidades* [National Council of Universities] (CNU), and *Instituto Nacional Tecnológico* [National Technology Institute] (INATEC) are currently seeking to strengthen teachers' knowledge and capacities through initial training, professionalization, graduate, and refresher programs.

50 Nicaragua ranks last among Central American countries in TERCE (*Tercer Estudio Regional Comparativo y Explicativo*) [Third Regional Comparative and Explanatory Study] test results (Unesco, 2014).

51 The 2017-2018 Global Competitiveness Index lists a labor force with limited education as the third most problematic factor for doing business.

52 On the Caribbean coast, however, it remains high. In 2014 it was 160.8 per 100,000 live births in the Caribbean Coast Autonomous Region, compared to 37.9 nationwide (Székely, 2016 and MINSA).

53 In 2014 it was 20 per 1,000 live births, compared to 15 in Latin America and the Caribbean (Székely 2016).

54 The under-five mortality rate (per 1,000 live births) is 21 nationwide in Nicaragua, 35 on the Caribbean coast, and 31 in rural areas, compared to 20 in Latin America and the Caribbean. The under-five chronic malnutrition rate is 17% nationwide and 22% in rural areas, compared to 12% in Latin America and the Caribbean (Székely, 2016).

55 The adolescent pregnancy rate per 1,000 women aged 15 to 19 is 92 nationwide in Nicaragua, 121 on the Caribbean coast, and 117 in rural areas, compared to 76.2 in Latin America and the Caribbean (Székely, 2016).

have 8 beds per 10,000 inhabitants, while the Latin America and Caribbean average is 15 beds. On the Caribbean coast, there are fewer than 10 health professionals per 10,000 inhabitants and 38% of households are located more than 5 hours away from a hospital.⁵⁶ Lastly, part of the population is beginning to suffer from the syndromes of higher-income countries, such as obesity and diabetes,⁵⁷ overloading the health system.

1.17 Nicaragua is one of the safest countries in Latin America and the Caribbean, which is a key asset for its development. The country's community-based social organization and a consensus approach in favor of conflict resolution⁵⁸ appear to have contributed to a drop in the homicide rate to 7 per 100,000 inhabitants in 2016—a 50% decline in 7 years—while the Latin America and Caribbean average was nearly three times as high (22.3) and the average for the rest of Central America was more than five times as high (38).⁵⁹ Nicaragua is also one of the countries in which crime and theft are least problematic for doing business (with an index of 1), better in this regard than Costa Rica (1.4), Honduras (13.9), and the rest of Central America (9.2).⁶⁰ In addition, there is a positive perception of the police, with 35% of the population reporting in 2017 that the police were somewhat or very trustworthy (Latinobarómetro, 2016). This perception of safety was an important factor in business investment decisions.

56 Social expenditure in Central America, Panama and Dominican Republic at a glance: 2007-2013. IDB, 2016.

57 From 2005 to 2016, diabetes rose from 6th to 4th place among the 10 leading causes of death.

58 Nicaragua has enabled the police to engage in community outreach by supporting community surveillance organizations and drug prevention and awareness programs (Insight Crime, March 2017).

59 WDI, World Bank Group.

60 The companies surveyed for the 2017-2018 Global Competitiveness Report selected the five factors they considered the most problematic for doing business, and the index is a weighted average of the interviewees' answers. In the case of Nicaragua, inefficient governmental bureaucracy, corruption, and an inadequate labor force are the most impactful factors, while crime and theft, inflation, and foreign currency regulations are the least impactful.



02

The Bank's Program

A. Relevance of the IDB strategy with Nicaragua

2.1 The objectives of the IDB Country Strategy with Nicaragua 2012-2017⁶¹ (Table 2.1) were aligned with the 2012-2016 National Human Development Plan (PNDH) launched by the Government of Nicaragua. The general objective of the country strategy was to contribute to Nicaragua's inclusive economic development, helping the country on infrastructure issues and on reducing the urban-rural divide in terms of poverty and access to services. The strategy prioritized four sectors: energy, transportation, health, and early childhood care. It also included three areas of dialogue (housing, water and sanitation, and rural productive development) and two crosscutting action areas (climate change, and gender and diversity). The country strategy delineated specific objectives for the priority sectors. These were aligned with the PNDH but turned out to be ambitious in sectors such as health and early childhood care.⁶²

Table 3.2 Energy objectives of the country strategy

Indicators	Target (2016)	Last (2016)	Country progress 2016-2012
ENEL's EBITDA margin	10%	3.6%	-1.8%
NATREL's EBITDA margin	5%	24.6%	27.9%
Cash recovery index of distribution companies	80%	78.3%	6.5%
Percentage of total system losses	21.15%	23%	-2.4%
Percentage of homes with electricity coverage	85.5%	90.1%	15.5%
Percentage of power generation from renewable sources	56.4%	52.8%	1.8%
Kilometers of transmission lines	2,811	2,269	520.39

Source: IDB Country Strategy with Nicaragua (2012-2017)

61 The IDB Country Strategy with Nicaragua 2012-2017 (document GN-2683) was approved in November 2012.

62 The objectives of the country strategy were to: increase the percentage of births in units offering emergency obstetric care in the 10 SILAIS presenting highest maternal mortality rates in 2010 from 60% to 75%; reduce unmet demand for family planning services among teenagers to 10% (no 2012 baseline); increase the coverage of comprehensive health care services for children under 3 in households living in extreme poverty from 30% to 60%; reduce the chronic malnutrition rate among children ages 0 to 5 (no 2012 baseline) to 20%; and reduce the incidence of anemia among children aged under 2 to 7% (no 2012 baseline).

- 2.2 In the context of preparation of the country strategy, OVE carried out a country program evaluation (CPE) covering the period 2008-2012 (document RE-422-3), and its recommendations were partially incorporated. As an input for the country strategy, OVE made five recommendations. The country strategy incorporated the recommendation to perform a strategic diagnostic assessment of the country's needs. The recommendations aimed at determining how to support the country in improving the efficiency of its public expenditure, enhancing the sustainability of projects, and strengthening the measurement and reporting of results were partially incorporated⁶³ and continue to be a challenge. Lastly, the recommendation to create countercyclical support was considered at the level of the IDB output menu (Annex II).
- 2.3 The lines of action proposed in the country strategy for the private sector windows were specific for the priority sectors, boosting their relevance to the rest of the program. In particular, in energy, the country strategy proposed using sovereign guaranteed (SG) and non-sovereign guaranteed (NSG) investment operations to finance energy generation and renewable energy investments, subject to the achievement of progress in strengthening the sector framework. In transportation, the strategy proposed providing support through public-private partnerships (PPPs). In health, it proposed pursuing synergies with the private sector in the context of improvements in service delivery capacity. The foregoing reflects the room for opportunities and potential synergies arising from SG and NSG instruments under the country strategy.
- 2.4 The country strategy created a framework of continuity that made it possible to anticipate the SG program. The anticipation of SG operations was high (79%) due to the continuity of the program and the Bank's medium- and long-term work relationship in the priority sectors. Anticipation was more of a challenge in the case of NSG operations—primarily subject to demand—and scattered technical cooperation operations, of which only 13% and 23%, respectively, were preprogrammed.⁶⁴

63 Worth noting is the support to the financial sustainability of the energy sector.

64 According to IDB rules, the country strategies do not provide a breakdown of operations. Instead, this is done in the framework of the Country Program Documents (CPDs) prepared each November with a view to estimating the loan and technical cooperation operations for the following year.

B. Relevance of the implemented program

- 2.5 The program consisted of 161 operations for a total of US\$1.9123 billion, including approvals in 2013-2017 and operations inherited from previous periods.⁶⁵ As of 1 January 2013, there were 51 operations with significant undisbursed balances totaling US\$474.4 million: 21 SG loans with US\$401.6 million in energy, transportation, and the social sector⁶⁶; six NSG loans⁶⁷ with US\$57.3 million; three investment grants with US\$8.2 million; and 21 technical cooperation operations with US\$7.2 million. The concentration of loan balances in energy, transportation, health, and early childhood care made their integration easier, since these priorities were continued under the new country strategy. In addition, 111 operations for US\$1.4378 billion were approved between 2013 and 2017.
- 2.6 Alignment between the implemented program and the strategic objectives of the country strategy was relatively high in the strategy's priority sectors, materializing in civil-works-intensive sectors in which the Bank had been working. As envisaged in the country strategy, energy, transportation, and health accounted for most (71.4%) of the new SG financing in the period.⁶⁸ In contrast, early childhood care accounted for only 0.01% of the approved amounts despite being one of the pillars of the country strategy. Thus, the Bank focused on civil-works-intensive sectors, including building infrastructure issues in the health sector, to boost the supply of services in areas with greater disparity. Seventy-four percent of the new SG resources went to civil works,⁶⁹ transportation being among the sectors that allocated the most resources to infrastructure (80% of SG resources). In addition, the continuity of the strategic pillars allowed the legacy portfolio, which was focused on energy,

65 Legacy operations are those that were executed mostly during the evaluation period (2013-2017) and had undisbursed balances exceeding 50% of the original amount, or an undisbursed amount greater than US\$5 million, at the start of the evaluation period (January 2013).

66 At the start of 2013, the portfolio included: five SG operations with a balance of US\$104.7 million; three in the transportation sector with a balance of US\$64.6 million; two in the health sector with a balance of US\$75.5 million; five in competitiveness and rural development with a balance of US\$72 million; two in water and sanitation with a balance of US\$31 million; one in fiscal management with a balance of US\$9.6 million; one in early childhood care with a balance of US\$30.9 million; and one in housing with a balance of US\$16.5 million.

67 Includes operations approved under the IIC, SCF, and OMJ windows, now IDB Invest.

68 The two largest approvals for the period were sequential loans: Road Integration and Transportation Sector Support (three operations for US\$269.2 million) and Support to the Electricity Sector (three operations for US\$175 million). The four operations in the health sector accounted for 23% of SG approvals and also provided continuity to a program that was being executed since the previous strategy period.

69 The analysis includes 14 investment loan operations with a total approved amount of US\$909.2 million, US\$675.1 million (74%) of which was allocated to infrastructure: 56.5% in transportation and communications, 29.5% in health, 8.3% in water and sanitation, and 5.7% in energy.

transportation, and health, to become integrated into the new country strategy, reflecting the Bank's medium- and long-term relationship with Nicaragua in these sectors.

- 2.7 The issues of public expenditure management, State reform, and subnational management became less relevant than in the previous country strategy. During the previous country strategy, the Bank's program in the sector accounted for 24% of the approved financing for the period. In contrast, during the evaluation period, the figure was 2% and consisted of technical cooperation resources aimed at institutional strengthening. In addition, approximately 5% of new SG resources went to institutional strengthening. This stands in contrast to the importance given to these issues in the PNDH, in the OVE Country Program Evaluation (CPE) with Nicaragua 2008-2012 (document RE-422-3),⁷⁰ and in the discussion on key barriers to development in the current country strategy. The foregoing is relevant, since the sustainability of the works and services financed through the program depends on factors that include institutional capacity, expenditure targeting, and adjustments in the sector frameworks.
- 2.8 The Bank's program approved significant resources in the dialogue areas and moderately addressed crosscutting issues in the loan operations. Seventeen percent of the SG approvals for the period fell under two of the areas of dialogue: value chains and rural development, and water and sanitation. In the former, two programmatic policy-based loans (PBLs) were approved, while, in the latter, significant nonreimbursable investment resources and an investment loan were utilized. In contrast, in the third area of dialogue, housing, the only action was to continue to provide technical cooperation resources for institutional strengthening.⁷¹ With respect to crosscutting issues, the gender component was integrated into roughly 40% of the investment loans. In addition, environmental impact assessments were conducted, and mitigation and adaptation measures were incorporated. In some cases, these measures were insufficient to mitigate the indirect environmental and social impacts of the works.⁷²

70 For example, OVE recommended that the Bank support the country in improving the efficiency of public expenditure and the financial sustainability of government enterprises.

71 Under the preceding strategy, a loan operation had been implemented in the housing sector involving the Nicaraguan Urban and Rural Housing Institute (INVUR) and MFIs. In this period, it was decided to further pursue market studies and institutional strengthening that would make it possible to adjust the financing mechanisms.

72 *Atlantic Coast Road Connectivity Project* (NI-L1087).

- 2.9 The implemented program was relevant because it focused on narrowing the urban-rural divide in terms of access to services, identified as a key development problem for Nicaragua. In energy, the program continued to focus on generation through renewable energy sources, on expanding and improving power transmission, and on increasing the national electricity coverage, with an emphasis on extending service to disadvantaged areas. In road infrastructure, the program focused on the connectivity between the rural centers of production and the major corridors and border crossings. Lastly, in health, the program focused on the regions with the lowest availability of services, seeking to close urban-rural gaps.
- 2.10 The program showed a preference for sequential operations with the same executing agencies. Seventy percent of the approved SG amount was for investment loans (14 operations for US\$942 million), while 21% was for programmatic policy-based loans (PBLs) (five operations for US\$285 million) and the rest for investment grants (nine operations⁷³ for US\$90.8 million) and technical cooperation projects (60 operations for US\$22 million). Almost half (41%) of the approved SG amount was for sequential operations with the same executing agencies: 20% for a sequential investment program in transportation (three operations, US\$269.2 million), 13% for three PBLs in energy (US\$175 million), and 8.2% for two PBLs in competitiveness (US\$110 million).
- 2.11 Operations with the private sector—mostly with financial intermediaries—fell by 12% with respect to the previous period. In the 2013-2017 period, 23 NSG operations were approved for a total of US\$98.6 million: US\$60.5 million through financial institutions and US\$38.1 million in direct loans to businesses.⁷⁴ Direct lending to SMEs and large companies contracted by 45% with respect to the previous period.⁷⁵ For its part, the Multilateral Investment Fund (MIF) focused on the productive sector, particularly agriculture, but with 20% fewer resources than in the previous period.⁷⁶ These reductions are the result of client access to alternative sources of financing and of strategy changes on the part of the SG windows of the IDB Group.

73 This amount includes two contingent grants: NI-G1006 and NI-G1007.

74 In addition, two uncommitted lines for foreign trade were approved under the Trade Finance Facilitation Program (TFFP) for a total of US\$13 million.

75 In the 2008-2012 period, "Structured and Corporate Finance approved a US\$30 million loan in the energy sector, [...], and a TC for US\$1.1 million. In addition, Opportunities for the Majority approved an agriculture sector operation for US\$9.5 million. The Inter-American Investment Corporation approved seven operations that totaled US\$71.2 million." CPE Nicaragua 2008-2012, document RE-422-3.

76 The MIF approved 22 operations for a total amount of US\$12.9 million, including operations by the Social Entrepreneurship Program and other complementary funds: US\$4.4 million went to 5 loans and US\$8.5 million to 17 technical cooperation operations. Nearly all operations were in support of the agricultural sector (US\$9.5

C. Financial relevance of the IDB in Nicaragua

- 2.12 Approvals for the period surpassed the level anticipated in the lending framework of the country strategy. In the 2013-2017 period, the Bank approved US\$1.2271 billion in SG loan operations, exceeding the base scenario projected in the country strategy (US\$856 million) by 43%. The higher level of financing was partly due to a modification in the share of soft lending resources allocated from the Fund for Special Operations (FSO). At the start of the period, Nicaragua had a 50/50 blend of FSO and Ordinary Capital (OC) resources. In view of the country's good execution and macroeconomic performance, this was modified in 2015 to a 40/60 blend.
- 2.13 Under tight coordination with the Government of Nicaragua, the Bank continued to be the country's main multilateral partner. The Bank accounted for 51% of the country's external public debt for the 2013-2017 period.⁷⁷ The Central American Bank for Economic Integration (CABEI) became the institution with the second-largest penetration in Nicaragua, followed by the World Bank, together accounting for 38% of the external public debt for the period.⁷⁸ For its part, the Government of Nicaragua seems to prefer a certain degree of specialization in its multilateral partners. For example, it relies on the World Bank for support in the areas of education and social protection.
- 2.14 The Bank had significant successes in attracting cofinancing. Fifty-six percent of the SG operations were leveraged by other multilateral agencies and donors (such as the World Bank, CABEI, EIB, COSUDE, European Union, AECID, and others).⁷⁹ Regarding the trust funds under management (the Bank succeeded in attracting more than US\$121 million in grants), it is worth noting the participation of the Korea Infrastructure Development Cofinancing Facility for Latin America and the Caribbean (in energy and broadband projects) and of the Spanish Water and Sanitation Cooperation Fund, which respectively provided 41% and 26% of the resources. The

million). The rest were for competitiveness improvement (US\$2.3 million), water and sanitation infrastructure (US\$0.82 million), and energy (US\$0.28 million). In the 2008-2012 period, this window approved 24 operations for US\$16.5 million.

77 In the previous period, the Bank accounted for 47% of the external public debt. Central Bank of Nicaragua (first half of 2017).

78 However, if the private sector debt were included, the Bank would drop to second place, surpassed by the bilateral contribution of Venezuela, which had annual placements of more than US\$500 million between 2010 and 2014.

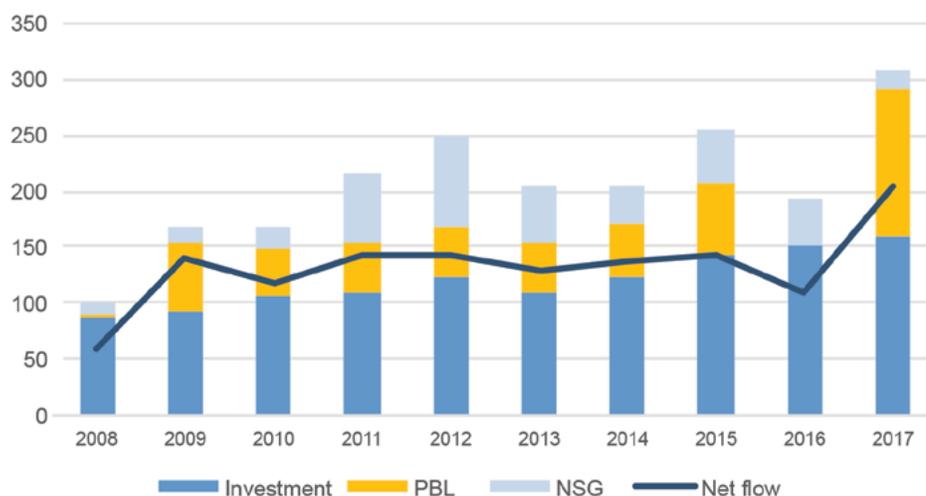
79 Cofinancing took place in the three priority pillars of the country strategy—transportation, energy, and health—with the Bank leading the dialogue and execution processes. The Bank's rules were applied to the entire financing.

country strategy did not envisage access to these strategic partners, which was obtained on an ad hoc basis and was very much appreciated by the Government of Nicaragua.

2.15 In 2013-2017, US\$1.0858 billion was disbursed by the country in SG and NSG loans, with positive net flows to Nicaragua during the entire period (Figure 2.1). Disbursements rose 32% with respect to the prior period (2008-2012). Net flows were positive for the country, peaking in 2017 due to the disbursement of US\$130 million from the third PBL in energy and the second PBL in competitiveness. However, 63% of the rise in disbursements for the period is attributable to an increase in investment loan disbursements. It is worth noting that half (52%) of the disbursements carried out during the 2013-2017 period corresponded to SG loans approved during the period. Of these, 59% went to road and power infrastructure and 22% to productivity improvement through two PBLs. NSG operations accounted for 10% of the disbursements for the period.

Figure 2.1
Disbursements and net flows (in US\$ millions)

Source: OVE with information from the IDB Group. Datawarehouse



D. Efficiency of the operations program and use of country systems

2.16 The costs and time involved in preparing and executing SG investment projects decreased significantly with respect to the previous period. The preparation costs per million approved for investment went from US\$12,260 in the 2008-2012 period to US\$3,882 in the 2013-2017 period (a 68% reduction), while the execution costs per million disbursed went from US\$32,666 to US\$23,638 (a 27% reduction). In addition, the time from eligibility to initial disbursement went from eight months in the

2008-2012 period to five months in the 2013-2017 period (a 42% reduction). The energy portfolio had the longest delay between eligibility and initial disbursement (10 months), reflecting the challenges involved in fulfilling conditions precedent.

- 2.17 Various factors contributed to this improvement, particularly the increasingly larger programmatic sequences with experienced executing agencies. The sequential focus of the Bank portfolio, particularly in transportation, the increase in the average size of operations (from US\$23.2 million in the 2008-2012 period to US\$66.3 million in the 2013-2017 period), the experience of the executing agencies, and simpler execution arrangements with fewer agencies made it possible to achieve lower preparation and execution costs.⁸⁰ In contrast, the least efficient operations were smaller and involved multiple executing agencies with varying levels of project implementation experience.⁸¹
- 2.18 Irrespective of the sector, implementation depended on the capacity of the executing agencies to manage civil works. Most of the program (70%) was allocated to works that required feasibility studies, designs, bidding processes, and monitoring. This was anticipated in the country strategy, which sought to identify new design and execution arrangements adapted to the local capacities. In experienced sectors, such as transportation, the execution costs were half the average, while in sectors with less experience in civil works, the costs were well above average.⁸²
- 2.19 The sectors with the least experience in the management of works, as well as complex projects, had trouble developing adequate designs, formulating terms of reference, and conducting bidding processes and evaluating bids.⁸³ These projects faced challenges that included cost underestimates

80 There is a noticeable difference, of 4% in preparation costs and 14% in execution costs, in favor of sequential projects with respect to non-sequential projects.

81 The operations with the highest preparation costs were the ones related to access to financing and broadband connectivity, with US\$16,592 per million approved, well above the country average. In addition, these are the lowest-volume operations in relation to the portfolio average. Similarly, these operations had the highest execution costs (US\$44,280 per million disbursed), joined by operations in agriculture and natural resources, tourism (US\$53,746 per million disbursed), and energy (US\$39,882 per million disbursed).

82 These sectors include agriculture and natural resources, tourism, and telecommunications.

83 For example, the energy projects experienced complaints and bid cancellations (NI-L1021, NI-L1022, and NI-L1036), as well as challenges with the executing agency, which exhibited difficulties with contract management. In other cases (NI-L1040, NI-L1050, and NI-L1063), there were challenges in defining the technical specifications and conditions of the products as well as in the bidding processes due to massive participation by providers.

and overestimates,⁸⁴ deficient and unrealistic designs,⁸⁵ failure to identify risks,⁸⁶ and cancellation of contracts.⁸⁷ A similar situation occurred in the case of complex projects—such as those in the energy sector—and when the circumstances required interinstitutional coordination, such as in broadband projects. The Bank generally responded ex post, modifying execution arrangements when coordination was not strictly necessary, creating interinstitutional technical committees, or facilitating technical cooperation resources to solve problems.

2.20 The Bank attempted to mitigate these weaknesses through institutional strengthening components in loans, as well as through technical cooperation operations. On average, 7% of the evaluated SG loan resources were allocated to institutional strengthening. Some sectors, such as value chains and rural development and water and sanitation, received greater support in this area (21% and 10%, respectively). The Bank also supported institutional strengthening through technical cooperation projects in the form of contract management consultants and workshops, procurement, and monitoring. The loans that received institutional strengthening support via technical cooperation operations had lower execution costs (22%) than those that did not.

2.21 In addition to institutional strengthening, technical cooperation operations served to create knowledge and respond to specific demands. The primary focus of technical cooperation resources was institutional strengthening. In the 2013-2017 period, the Bank approved US\$22 million for technical cooperation operations and had US\$7.3 million in undisbursed resources at the start of the period.⁸⁸ Almost half of the technical cooperation resources (47.8%) were used to provide technical capacity to various Nicaraguan government agencies.⁸⁹ Meanwhile,

84 Works were reformulated (NI-L1039) and cost management systems were implemented (NI-L1049).

85 Deficiencies were identified in the engineering designs for stormwater drainage works, giving rise to an involuntary resettlement (NI-L1010); basic errors were detected that compromised the functionality of the laboratories and the possibility of future ISO 17025 certification (NI-L1067); the designs of works were not adapted to the actual construction terrain (NI-L1029, NI-L1048, NI-G1002).

86 In the case of NI-L1048, 25% of the works had structural design problems and created risks to the communities. The COSUDE funds made it possible to take corrective steps.

87 For example, in rural areas it was difficult to find layouts that complied with economic feasibility criteria, leading the MTI to create a bank of projects through the preinvestment component of program NI-L1097. In other cases (NI-L1039, NI-L1067, NI-L1084), contracts had to be cancelled.

88 This amount includes five Action Plan for Group C and D Countries technical cooperation operations for US\$2.6 million.

89 Examples include training in project planning and management as well as results-based management, methodologies for technical analysis and regulatory/legislative analysis, and information systems for identification of beneficiaries. In some cases, the institutions also benefited from the experience in other countries through CT-Intra resources.

34.4% of technical cooperation resources financed knowledge products, including diagnostic and impact assessments that in some cases were performed in response to specific requests from the Government of Nicaragua and proved useful for the design of public policies. Lastly, 11.3% addressed specific issues in the preinvestment phase, and 6.5% addressed specific demands from clients.⁹⁰

2.22 The use of country systems was addressed through a legacy operation, with moderate but positive advances.⁹¹ These advances include the outcomes of the legacy loan operation Public Sector Financial Management System Modernization Project (NI-L1033), aimed at helping the government to enhance the efficiency and transparency of public expenditure management through an Integrated Administrative and Financial Management System (SIGAF). In October 2017, the government presented the 2018 national budget using the SIGAF, reflecting the efforts to consolidate the financial administration subsystems,⁹² the implementation of a results-based budgeting methodology, and the automation of operations. The project also supported the internal auditing unit. The results indicators point to a certain degree of improvement in the efficiency and transparency of expenditure management.⁹³ Internal and external governmental control received support in adopting an audit control, planning, and quality assurance system. With regard to the country procurement system, the Government Procurement Department (DGCE) was strengthened, and the implemented information subsystem is being used in all Bank loans. In addition, the Bank provided support via training to the executing agencies in contract management and procurement process.

90 There were technical cooperation operations for specific issues such as inclusion of at-risk youth through artistic training or strengthening of a rural education program managed by a nongovernmental organization (NGO). In addition, Nicaragua received US\$2.6 million in technical cooperation resources through the Action Plan for Group C and D Countries, managed from the IDB Country Office in Nicaragua.

91 Public Sector Financial Management System Modernization Project (NI-L1033).

92 This is the first time that the system is being used to formulate the budget. The subsystems include budget, accounting, public credit, procurement, civil service, and public investment.

93 For example, there was an increase in the positive perception of the quality of services and information provided by the SIGAF (from 60% in 2010 to 80% in 2015), and a reduction in the average time it takes to prepare and issue central administration financial statements (from six months in 2010 to four months in 2015).



03

Effectiveness of the Operations Program

3.1 This chapter examines the results of the IDB Group program of loan and technical cooperation operations. The chapter is divided into the priority sectors as defined in the country strategy (section A), dialogue areas (section B), and other areas in which work was done by the IDB Group but which were not defined as priority areas in the country strategy for 2013-2017 (Table 3.1).

Table 3.1. Executed portfolio of the IDB Group 2013-2017

	Area	Balances as January 2013	Approved amount 2013-2017	Number of loans				Nonreimbursable operations ¹		
				Legacy		2013-2017		Legacy		2013-2017
				SG	NSG	SG	NSG	SG	NSG	SG
Priority sectors	Energy	133.7	310.5	5	1	5		1		8
	Transportation and logistics	64.8	410.7	3		5		1		5
	Health	76.5	302.6	2		4		1		7
	Early childhood	31.2	0.2	2				1		1
Areas of dialogue	Housing	35.2	0.7	1	2			1		2
	Water and sanitation	31.5	105.8	2		1			1	6
	Value chains/ Rural development	73.5	118.4	5		2		5		12
Other sectors	Public management	11.5	18.8	1				8		22
	Citizen security	0,5	0.7					2		1
	Telecommunications		50.7			1				1
	Access to financing ²	5.7	80.7		1	1	9	2		3
	Social Protection	1.6	0.012					1		1
	Businesses	8.8	38.1		2		14			
	TOTAL	474.5	1,437.9	21	6	19	23	23	1	69

¹Includes investment grants and technical cooperation operations.

²Does not include the lines from the Trade Finance Facilitation Program.

Source: OVE based on information from the IDB Group Datawarehouse and own analysis.

A. Priority sectors

3.2 **Energy - Objectives of the country strategy:** (i) improve the financial and operational management of the system and reduce energy losses; (ii) expand electricity service coverage, particularly in rural areas; (iii) improve the service's reliability; and (iv) transform the energy matrix to increase the share of renewable sources. The private sector windows will aim to finance energy generation and renewable energy investments.

- 3.3 In the 2013-2017 period, a total of US\$278.6 million of the evaluated portfolio was disbursed under four energy programs⁹⁴ through the public sector window of the IDB Group. The Bank's action in this sector was relevant insofar as it was aligned with the objectives of the PNDH and focused on improving the sector's financial and operational stability and the provision of service in areas with lower service coverage. The Bank's program continued to focus on generation from renewable sources, including geothermal energy. In addition, the Bank financed investment operations in power transmission and distribution that made it possible to expand national electricity coverage. 59% of Bank financing targeted rural regions and areas with lower coverage. At the same time, the private window of the IDB Group continued to disburse a loan for construction of a wind farm in the southeast of Nicaragua with an installed capacity of 39.6 MW.
- 3.4 In the financial and operational management area, the Bank supported sector sustainability through a programmatic series of loans that produced mixed results. A series of three PBLs for a total of US\$175 million was approved to support financial management, reporting transparency, and regional integration reforms. The first operation helped primarily to facilitate the financial recovery of the energy matrix. The policy conditions were relevant, and the government made strides in terms of trigger mechanisms, consolidating the reform process. In addition, the Bank approved a technical cooperation operation (NI-T1185) for US\$450,000 to strengthen the institutional capacity of the sector.⁹⁵ The results were partially satisfactory, insofar as progress is evident in both the financial management of the National Power Transmission Company (ENATREL) and the cash recovery index of the distribution companies. In contrast, the Nicaraguan Electricity Company (ENEL) showed a drop in its profit margin before interest (EBITDA) (Table 3.2). The sector still needs to continue to make efforts toward achieving sustainability by reducing transmission losses, maintaining the existing infrastructure, deepening the antifraud regulations, and normalizing irregular customers.

94 The Electricity Sector Support Program, with the participation of the CABI and the EIB; the National Sustainable Electrification and Renewable Energy Program (PNESER), with the participation of the Korea Eximbank, CABI, EIB, OPEC Fund for International Development (OFID), Japan International Cooperation Agency (JICA), Latin America Investment Facility (LAIF), and the Nordic Development Fund (NDF); the Geothermal Exploration and Transmission Improvement Program, with financing from the Ministry of Energy and Mines (MEM), National Power Transmission Company (ENATREL), and the Nicaraguan Electricity Company (ENEL); and the Program to Strengthen the Electricity Sector in Nicaragua.

95 MEM, *Instituto Nicaragüense de Energía* [Nicaraguan Energy Institute] (INE), and *Centro Nacional de Despacho y Carga* [National Dispatch and Load Center] (CNDC).

Table 3.2. Energy objectives of the country strategy

Indicators	Target (2016)	Last (2016)	Country progress 2016-2012
ENEL´s EBITDA margin	10%	3.6%	-1.8%
NATREL´s EBITDA margin	5%	24.6%	27.9%
Cash recovery index of distribution companies	80%	78.3%	6.5%
Percentage of total system losses	21.15%	23%	-2.4%
Percentage of homes with electricity coverage	85.5%	90.1%	15.5%
Percentage of power generation from renewable sources	56.4%	52.8%	1.8%
Kilometers of transmission lines	2,811	2,269	520.39

Source: IDB: Country Strategy with Nicaragua (2012-2017).

3.5 The program shows advances in terms of coverage, transformation of the matrix, and financial sustainability of the sector.⁹⁶ As of year-end 2017, the Electricity Sector Support Program and PNER had completed 239 km of transmission lines, expanded and modernized more than 40 substations, installed 19 transformers, rehabilitated one hydropower plant, built the Central America plant bypass (with additional funding from the CABI), and installed 2.16 million energy saving and energy efficient lights. This resulted in more than 101,400 homes newly connected to the electricity service (55,000 in disadvantaged neighborhoods and informal settlements)⁹⁷ and 1,900 users newly connected through renewable energy projects in isolated systems.⁹⁸ The Bank's support helped to increase the number of homes with electricity coverage by 11.3 percentage points between 2012 and 2016 (73% of the total progress nationwide), exceeding the target established for 2017 in the country strategy (Table 3.2). Despite these strides, electricity prices remain high, limiting the country's competitiveness. These prices are the result of long-term power purchase agreements signed in a context of high oil prices.⁹⁹

96 These advances take into account the support of other co-lenders: Electricity Sector Support Program (EIB, CABI) and PNER (EIB, CABI, KEXIM, OFID, JICA, EU/LAIF, NDF).

97 With a target of 168,000 for 2018.

98 With a target of 1,906 for 2018.

99 The costs for the industrial sector averaged US\$0.25 per kWh, compared to US\$0.067 in developed countries such as the United States. ECLAC, 2015, and USEIA, 2016.

- 3.6 Transportation and regional integration - Objectives of the country strategy:** *(i) improve the road network linking rural centers of production with the main corridors and border crossings, while also facilitating access to social services for the population living in poverty; and (ii) institutionally strengthen the Ministry of Transportation and Infrastructure (MTI) and the Road Maintenance Fund (FOMAV) in technical, administrative, and management terms, with an emphasis on the design of works, execution capacity, contract management, and program monitoring and evaluation. In addition, the country strategy proposed exploring public-private partnership (PPP) initiatives for the sector.*
- 3.7 The objectives for the sector were aligned with the country's priorities and lent continuity to the Bank's previous strategy while placing a stronger emphasis on institutional strengthening. The National Transportation Plan (2014-2033) stresses the need to continue to improve road conditions and the connectivity between the areas of production and the access to ports and airports. In the 2013-2017 period, in transportation and logistics, the Bank approved five loans for US\$385.7 million and five nonreimbursable operations (technical cooperation operations and investment grants) for US\$25 million, which accounted for 36.37% of the approved portfolio. In addition, three loan operations and one technical cooperation project from the previous strategy, which had an undisbursed balance of US\$64.8 million, were executed.
- 3.8 The executed portfolio focused on the connectivity of the Pacific corridor, the Atlantic coast, production zones, and regional integration through border crossings. The greatest progress was made on the trunk road network of the Pacific corridor. The Transportation Sector Support Program¹⁰⁰ focused on improving the roads that form a part of the Pacific corridor, including those connecting with El Guasaule (in Honduras) and Peñas Blancas (in Costa Rica). Of the 172.5 km expected to be rehabilitated by 2018 under this program, 163.17 km had been rehabilitated as of 2017. The program also included institutional strengthening, supporting the FOMAV in its implementation of a service results-based maintenance system. In addition, a road safety strategy was prepared and the locations most vulnerable to the effects of climate change were mapped. The Border Integration Program targeting the border crossings of Peñas Blancas, San Pancho, and El Guasaule experienced difficulties in the preinvestment stage and complications in interinstitutional coordination. However, 34% of the resources were disbursed by

¹⁰⁰ Two of the loans were approved under the previous country strategy (PAST I, NI-L1049, approved in 2010 for US\$20.2 million; PAST II, NI-L1052, approved in 2012 for US\$39.2 million); and PAST III, NI L1071, was approved in 2013 for US\$91.5 million.

year-end 2017 and, while not all of the outputs expected for 2017 were achieved, advances were made in projects aimed at a regulatory reform of customs control processes.

- 3.9 The Atlantic Coast Road Connectivity Program and the Road Integration Program in productive areas show progress. Climate factors, changes in project design, and the lack of a feasible project portfolio initially delayed their execution, but these obstacles have since been overcome. The Atlantic Coast Road Connectivity Program (NI-L-1087), approved for US\$61.5 million, is highly relevant as it supports permanent connectivity (currently nonexistent) between the country's Pacific and Atlantic coasts (La Gateada-Naciones Unidas-Bluefields section). At the start of the program there were delays due to climate conditions and changes in the longitudinal profile.¹⁰¹ These delays were offset by achieving a higher-than-expected target in 2017 (of a total of 46.1 km to be paved, 15.45 km were completed, slightly exceeding projections). Despite being a category A program according to the Bank's environmental and social classification, the program did not provide for sufficient resources and measures to mitigate the indirect environmental and social impacts that could result.¹⁰² For its part, the Road Integration Program¹⁰³ is aimed at providing access to productive rural areas with high poverty levels. Due to the initial difficulty in identifying works that would comply with the feasibility criteria, as mentioned in the interviews with the executing agency, 5.2% of the resources were allocated to preinvestment studies and, as of 2017, 15 new designs were committed for future sections.
- 3.10 The contribution of the Bank's program in the sector reflects financial and technical relevance, with greater progress in road connectivity. The sector requires a continuation of efforts in road connectivity and in road maintenance financing. The Bank's evaluated program in the sector contributed to the rehabilitation of 227.2 km (20% of the total nationwide progress) and provided the FOMAV with resources to expand the road network under its jurisdiction. Thus, maintenance was provided on 133.2 km (42% of the total nationwide progress) (Table 3.3). In addition, the Bank supported the FOMAV in implementing

101 In 2017, envisaging greater freight traffic in view of the potential development of the Bluefields port, the borrower requested changes in the sinuosity of the road, which would affect its longitudinal slope and require more excavation. The feasibility of this is being analyzed with the support of a technical cooperation operation (NI-T1233).

102 According to ESG's December 2016 Supervision Report (ASR), the ESMP does not provide sufficient measures to mitigate the indirect impacts on protected areas, and despite the allocation of resources to assess the status of migration and land use in the corridor's areas of influence, no resources have been allocated to implement any of the measures arising from the study. This was corroborated in the visits conducted by OVE.

103 The first operation under this program was approved in 2015 for US\$90.7 million (NI-L1092), and the second operation was approved in 2016 for US\$87 million (NI-L1097).

a service-results-based maintenance system, which made it possible to focus resources on new kilometers of maintainable network and helped to improve the FOMAV's sustainability since, as mentioned, this type of contract can create savings of up to 30% in road maintenance. The Bank also supported the MTI in preparing an institutional strengthening action plan and a road safety strategy. Of the four goals outlined in the IDB country strategy, those related to road paving were met. However, the percentage of basic road network in good or very good condition and the kilometers maintained by the FOMAV increased less than expected (93% and 95%, respectively). This is principally due to an increase in the number of kilometers in the basic road network and maintainable network. Additionally worth noting is the lack of resources for maintenance of the basic national road network under FOMAV jurisdiction. For the same reason, the sustainability of the operating and paved network is in jeopardy. At present, the FOMAV has a shortfall in its budget for servicing the network.¹⁰⁴ In 2016, it serviced 66% of the road network, financing 52% of this with IDB and World Bank resources.

3.3. Objectives of the country strategy in transportation

Indicators	Target (2017)	Last (2017)	Country progress 2016-2012
Kilometers of paved network built (km)	4,293.7	4,279.3	-1.8%
National paved road coverage (km/km ²)	0.033	0.033	0.009
Percentage of basic road network in good or very good condition	48.4	44.82	17.32
Kilometers of road network under maintenance by FOMAV	3,500	3,317	317.04

Source: IDB Country Strategy with Nicaragua (2012-2017).

3.11 **Health - Objectives of the country strategy:** *improve maternal, neonatal, and perinatal health, reduce risk factors for chronic degenerative conditions (in particular obesity), and cut child malnutrition, in particular chronic malnutrition among children under three.*

3.12 The Bank's program in this sector was relevant insofar as it gave continuity to the work model in the sector under the previous country strategy, focusing on expanding coverage of, and

¹⁰⁴ The absence of a financing source that can generate sufficient resources for FOMAV to perform its duties has been in evidence since 2009.

improving, maternal and infant health services in regions with lower coverage. However, the objectives of the country strategy turned out to be ambitious with respect to the program that was actually implemented. Under the 2013-2017 country strategy, the Bank approved US\$298 million in loans, US\$3.6 million in investment grants, and US\$0.93 million in technical cooperation operations for the health sector. In addition, there was US\$76.5 million in undisbursed funds. Thus, the Bank's portfolio in the sector totaled US\$379 million (20% of the portfolio). The operations prioritized investments in health infrastructure, equipment, and strengthening of human resources.

3.13 Health sector operations prioritized an expansion of coverage in the country's northwest.¹⁰⁵ Progress is evident in maternal health care and family planning services. The program for Improving Family and Community Health in Highly Vulnerable Municipios (NI-L1054), supplemented by the *Salud Mesoamérica* Initiative (SMI) operations, was aimed at improving maternal and infant health care services, promoting demand, and ensuring service quality in the country's northeast. The program succeeded in raising the percentage of women who use family planning services from 16.9% in 2009 to 19.7% in 2015, and the percentage of pregnant women who go to maternity homes from 12.8% to 21.3% over the same period.¹⁰⁶ In addition, in the period from 2012 to 2014, together with the Integrated Health Care Networks Program (NI-L1068), the Bank financed health care in 66% of deliveries in the northeast region. With regard to infrastructure, the Modernization of Hospital Infrastructure and Management Program – West Region, also funded with SMI resources, supported the improvement of five health care networks in the western portion of the dry corridor. In addition, three hospitals¹⁰⁷ and 30 health units (NI L1095, NI L1082, and NI L1068) were built, and 30 health units were rehabilitated through other programs (NI L1068 and NI L1095).¹⁰⁸

3.14 The operations were also aimed at improving the quality of services through institutional and human capital strengthening. The Bank financed the training of 123 municipal health teams (NI-L1081), 858 individuals in pregnancy care and records

¹⁰⁵ Bilwi, Las Minas, Jinotega, and Matagalpa. Thirty-three of the country's 153 municipios, and those which suffer the most from climate change, are located in the Dry Corridor region comprised of the departments of León and Chinandega (West) and Estelí, Madriz, Matagalpa, and Nueva Segovia (North).

¹⁰⁶ Regarding the outcomes of the other programs, the target years have not yet arrived: (NI-L1059 (2018), NI-L1068 (2018), NI-L1081 (2018), NI-L1082 (2018 and 2020), and NI-L1095 (2018 and 2021).

¹⁰⁷ The largest hospital being the new HEODRA. The current HEODRA hospital employs one third of the medical personnel in the country.

¹⁰⁸ Once execution of the loan operations is completed, it is expected to result in sev hospitals, 59 health units, 100 community institutions (casas bases), and six maternity homes, as well as 45 rehabilitated facilities.

(NI- L1054), and 500 individuals in clinical and emergency health (NI-L1082). In addition, the Integrated Health Care Networks Program supported the development of Family and Community Health Model (MOSAFM) management standards in seven Local Integrated Healthcare Systems (SILAIS). The program for Strengthening of Community Health and Extension of Health and Nutrition Services in Communities in the Dry Corridor Region (NI-L1081) supported the Ministry of Health (MINSAL) in expanding services and reinforcing human resource management.

3.15 The Bank's program in the sector made significant progress in terms of outputs, but limited progress in terms of outcomes. There is a noticeable improvement in key national indicators, such as a drop in neonatal and infant mortality. As of year-end 2017, the program had disbursed 38% of its resources and is expected to conclude in 2022. Due to the precarious condition of the MINSAL's monitoring and evaluation systems, there is no up-to-date information regarding progress on the results matrix indicators set out in the country strategy. At the national level, advances have been made by reducing neonatal and under-5 mortality per 1,000 live births from 10.1 to 8.8 and from 22.7 to 19.7, respectively, between 2012 and 2016. The sustainability of these advances is in jeopardy, since the government lacks the budgetary capacity to absorb the operating and maintenance costs of the services offered through the Bank program.

3.16 **Early childhood care – Objectives of the country strategy:** *improve access and increase the use of comprehensive early childhood services in areas of high social vulnerability, by: (i) expanding coverage and diversifying quality comprehensive services for early childhood; (ii) strategic and institutional strengthening of the early childhood welfare system.*

3.17 Comprehensive early childhood care operations were relevant insofar as they expanded access to services in highly vulnerable areas, but the sustainability of their outcomes is partial. In the 2013-2017 period, the Bank approved US\$150,000 in technical cooperation resources. In addition, the Bank continued to execute US\$31.2 million from two legacy operations (Urban Welfare Program for Children in Extreme Poverty, NI0155, and Program to Support Implementation of the National Early Childhood Policy in Targeted Communities, NI-L1059). These operations expanded access to community comprehensive early childhood services. Fifty Community Child Care Centers (CICOs) were built, 231 community spaces and early stimulation rooms were rehabilitated, and more than 7,000 professionals were trained in providing basic services in CICOs or home visits to children under six. The outcomes of the home visits program

point to improvements in childrearing practices and a drop in chronic child malnutrition, which went from 12.6% in 2013 to 10.54% in 2015 in the program's beneficiary neighborhoods. The sustainability of the outcomes is partial. Although the municipal governments took over the CICO services, the psychosocial care and home visits were discontinued.

B. Areas of dialogue

- 3.18 Housing and water and sanitation were areas of dialogue under the 2012-2017 country strategy but lacked specific strategic objectives. In the housing sector, the Bank approved two technical cooperation operations in the 2013-2017 period for institutional strengthening of the Nicaraguan Urban and Rural Housing Institute (INVUR),¹⁰⁹ for US\$742,000 (0.06% of the approved portfolio).¹¹⁰ In the water and sanitation sector, new operations were aimed at expanding urban water and sanitation coverage (two loans for US\$104.3 million) and at expanding the institutional capacity of ENACAL (three technical cooperation projects for US\$1.2 million).¹¹¹
- 3.19 In the housing sector, the IDB Group program was relevant because it continued to disburse three operations that supported access to housing for vulnerable population groups and basic infrastructure for municipalities, but its scope was limited. The execution of three legacy operations in the housing sector was continued in the 2013-2017 period. The public window¹¹² supported the construction and improvement of homes through subsidies with and without credit, improvement of infrastructure and basic services in marginal urban neighborhoods, formalization of land tenure, and capacity-building at the INVUR. The program delivered more than 13,000 subsidies, falling short of the goal of 15,900. Cost underestimates (due to the technical assistance provided to beneficiaries, a component that was not considered), coupled with a reduction in the credit component (due to the lack of experience of the microfinance institutions (MFIs) and

109 A technical cooperation operation to support the results-based management model of the INVUR was approved in 2013 (NI-T1182), and another technical cooperation operation to analyze financing mechanisms for low-income housing was approved in 2015 (NI-T1223).

110 In early 2013, the undisbursed total was US\$34.8 million, including US\$16.8 million in SG operations (NI L1053 and NI-T1133) and US\$18 million in OMJ-approved loans to the private sector for operations in the housing sector.

111 The portfolio includes one technical cooperation operation for the irrigation strategy (US\$300,000) and three operations with a balance of US\$31.5 million.

112 The credit-included modality provided a subsidy of up to US\$1,500 for households earning two to three times the minimum wage. The no-credit modality provided a subsidy of up to US\$2,500 for households earning up to twice the minimum wage, combined with a contribution of up to US\$1,200 from auxiliary agencies.

the INVUR in projects of this type, although this effect was offset by the increase in subsidies without credit) and in the property regularization component hindered achievement of the goals. Despite its successful appropriation by the beneficiaries, the program failed in some cases to consider comprehensive neighborhood improvement solutions such as solid waste treatment.¹¹³ At the same time, two legacy operations approved through the private sector window were executed. These operations provided second-tier financing focused on housing projects for vulnerable population groups and basic infrastructure projects for municipalities. The support to this population segment was relevant in view of the lack of depth of the mortgage market¹¹⁴ and the housing deficit for the target population. The operations included a participatory arrangement that ensured the sustainability of outcomes¹¹⁵ and sought to create demonstration effects on the supply of this type of credit. Despite the foregoing, the model was not scaled to the national level.

3.20 The water and sanitation portfolio focused on expanding the coverage of drinking water and sanitation services, primarily in urban areas. The portfolio includes the Bilwi (Puerto Cabezas) Drinking Water Project (US\$31.4 million), which supports an increase in the coverage of drinking water services, primarily in the above-mentioned city. The location of this project is relevant in a context of low coverage.¹¹⁶ In addition, execution of the Water Supply Program for Managua (US\$30 million) was completed, increasing the number of households (more than 16,000) with a continuous (more than 16 hours) drinking water supply and shortening the response time for pipe repairs.¹¹⁷ The sustainability of outcomes will depend on whether funds are allocated for maintenance of the works and on whether the households actually connect to the network.¹¹⁸

113 The visit revealed the existence of a neighborhood located next to open-air garbage dumps.

114 The Bank is at present analyzing the mortgage market (NI-T1223) so as to propose instruments that can incentivize credit supply and demand and greater private sector involvement.

115 The community prioritized improvements in the neighborhood and committed to work with the *municipio*.

116 As of 2014, 45% of the population in the Autonomous North Atlantic Region (RAAN) lacked drinking water, making coverage in this region one of the lowest, and only 13.2% of homes had access to a safe drinking water supply system (WHO, 2015).

117 Going from 72 hours to six hours to repair pipes with diameters of less than 10" and from 24 hours to eight hours to repair pipes in the sanitation system.

118 The water and sanitation systems' maintenance plan was not executed, since it was alleged that ENACAL was performing maintenance activities. However, ENACAL's maintenance is only corrective. The program had problems in the design of works and did not call for awareness-raising activities to encourage users to connect to the sewerage network. To date, only 51% of homes are connected to the network.

- 3.21 Regarding stormwater drainage issues, the Bank approved a Stormwater Drainage and Development Program in Subwatershed III of Managua for US\$13 million. This program sought to mitigate the risks of floods and landslides in the lake's watershed and strengthen the environmental management and land-use planning capacity. The program succeeded in reducing the number of inhabitants at risk from floods and increased the capacity for solid waste collection in the targeted municipios by 40.5%. In addition, the land-use plans and municipal regulatory plans were approved. The issue of sustainability of outcomes is worrisome, as the revenue collected in the targeted areas does not cover the waste collection and treatment costs.
- 3.22 Value chains and rural development were identified as areas of dialogue under the country strategy, but in the absence of strategic objectives or targets, the country strategy was not useful as a guide. The Bank approved two PBLs for US\$110 million focusing on financial regulatory reforms and business climate improvement. In addition, there were undisbursed balances in the amount of US\$61.9 million from two operations to support rural development and agricultural sector productivity (US\$47.2 million), the National Tourism Program (US\$8.5 million), and the Foreign Trade Support Program (US\$6.2 million). Of this amount, there is still an undisbursed balance of US\$4.8 million from an agricultural productivity project.
- 3.23 The Bank supported the development of value chains through two PBLs for US\$110 million that focused on financial regulatory reforms and business climate improvement and were relevant for the sector. The first operation focused on increasing financial inclusion in the productive sector through financial regulatory reforms (micro- and macroprudential), development of new financial instruments, and support for the Banco de Fomento de la Producción [Production Development Bank] (BFP). The second operation supported the implementation of these reforms and the institutional changes required to facilitate promotion of the sector and improvement of the business climate (PRONicaragua, Ministry of Development, Industry, and Commerce (MIFIC); and Ministry of Family, Community, Cooperative, and Associative Economy (MEFCCA)). Despite advances in the implementation of regulations on MFIs—with the support of technical cooperation operations—and in access to financing, this issue continues to be a barrier for small businesses, which finance a mere 25% of their productive investments through loans.¹¹⁹ The foregoing points up the need to continue to make efforts to ensure lasting impacts on

119 Enterprise Surveys, World Bank, 2018.

financial inclusion, improve the business climate, and examine the role of development banks *vis-à-vis* other actors in the financial system.

3.24 Of the programs to support rural development, the greatest advances were achieved by the Environmental Program for Disaster Risk and Climate Change Management. The program supported the adoption of environmental restoration systems and infrastructure to reduce losses caused by natural disasters. Despite design flaws in some infrastructure works, the evaluation of the sustainable agricultural practices component indicates that the program's beneficiaries not only adopted the environmental restoration practices that were promoted, ensuring the sustainability of outcomes, but also increased their agricultural productivity, water collection capacity, and sales of cattle and milk. On the other hand, the Sustainable Agricultural Productivity Development Program, approved in 2012 and affected from the outset by execution delays that were overcome in 2015, is moving forward on the construction of works and development of outputs,¹²⁰ and therefore has no outcomes yet. Operational and financial sustainability will depend both on the adoption of practices by beneficiaries and on institutional strengthening and allocation of national budget resources.

3.25 The National Tourism Program¹²¹, focused on San Juan del Sur and Granada, made significant strides in terms of outputs, but its contribution to the observed outcomes cannot be established. The program achieved its objectives of expanding the tourism offerings in the targeted regions by setting up and improving the tourism infrastructure (for example, coastal scenic road upgraded, cultural and leisure center set up in San Juan del Sur, historical and colonial circuit in Granada improved). The outcome indicators notably include an increase in the number of foreign tourists in San Juan del Sur, in the formality and quality of tourism service providers, and in the capacity for service to tourists. However, there has been a drop in tourism spending (14% and 26% in San Juan del Sur and Granada, respectively) and average stays in the areas of intervention. In addition, a decline is evident in institutional capacity in terms of control

120 Building to house the *Instituto de Protección y Sanidad Agropecuaria* [Agricultural Protection and Health Institute] (IPSA), strengthening of the IPSA in terms of strategic planning and management, financial sustainability, staff training, monitoring systems, and operational traceability, *Encuesta de Producción Agroecológica* [Agroecological Production Survey], infrastructure of the *Instituto Nicaragüense de Tecnología Agropecuaria* [Nicaraguan Institute for Agricultural Technology] (INTA), rehabilitation of technology development centers and experimental stations, technology monitoring and collection unit, research protocols, improved seed production, and producers receiving technologies.

121 It focused on developing tourism offerings in San Juan del Sur and Granada and on strengthening the private and institutional segments of the tourism production chain through technical assistance and experience-sharing.

and regulation of tourism offerings.¹²² Institutional weakness and the absence of both a regulatory sector framework and a strategy to guide public and private interventions jeopardize the outcomes achieved.

3.26 The Export Support Program financed relevant outputs for the sector, but its contribution to some of the observed outcomes cannot be established. The operation was aimed at encouraging exports, attracting investments, and strengthening the national export quality system, including beef traceability. Despite having attained the target for virtually all outputs (92%), the program's causality in SME exports and in attracting FDI cannot be established, given the absence of evaluation arrangements that would have provided baseline measurements at the start of the program. The implementation of the beef traceability system continued through the Sustainable Agricultural Productivity Development Program, but with very limited expansion to additional geographic areas or to other outputs. The sustainability of outputs of the Export Support Program was sought through institutional strengthening of the program's relevant agencies (e.g., ProNicaragua and MIFIC).

C. Other sectors

3.27 Access to financing: The IDB Group channeled resources through the BFP, financial institutions, and MFIs in a relevant segment but achieved limited financial additionality. The IDB Group channeled US\$80.6 million to MSMEs through the BFP¹²³ (US\$30.1 million), financial institutions (US\$45 million), and MFIs (US\$5.5 million). While the BFP loans focused on small and medium-sized producers in the agricultural sector (62% of the total loan portfolio),¹²⁴ private banks provided financing to MSMEs in various other sectors. Although the BFP operation reached a relevant market through loans to NGOs and cooperatives (72% of clients), these borrowers only received 29% of the resources and for a term of less than two years.¹²⁵ In addition, the subloans it channeled through MFIs were also for a term of less than one year. In contrast, the loans provided through financial institutions were placed in the commercial sector¹²⁶ with average maturities of four to five years. The latter

122 A reduction of 6.41 percentage points in the number of rated tourism establishments.

123 The BFP channeled resources through financial institutions, MFIs, NGOs, and storage and/or trading cooperatives.

124 In particular, they supported cattle, coffee, and cocoa chains (NI-L1046), and cocoa, dairy, Robusta coffee, vegetables, fruits, tubers, and oil products (NI-L1080).

125 *Final Evaluation Report*, IDB Program 2203, p. 16.

126 Fifty-three percent of the microenterprises, 80% of the small enterprises, and 56% of the medium-sized enterprises receiving credit are from the commercial sector.

are similar to market maturities and to the maturities of SME loans according to the Evaluation of IDB Group's Work through Financial Intermediaries (51 months). Lastly, the lines provided under the Trade Finance Facilitation Program (TFFP) supported 534 individual foreign trade transactions for US\$66.5 million—US\$33.8 million through loan guarantees and US\$32.7 million through A loans. These lines primarily facilitated the financing of foreign trade transactions involving processed foods (37%), agricultural products (21%), and manufactured products (16%).

- 3.28 The corporate loans that were directly channeled through large companies and SMEs were of limited relevance and additionality. Nearly all the resources (94%) of these operations were allocated to large, market-leading, exporting companies with access to financing. Most of these borrowers are in the agroindustry sector and some include agricultural MSMEs as input providers or product distributors. Although these operations found a relevant niche providing financing to businesses that form part of production chains, they did not establish goals in terms of development. Financial additionality was limited since the operations supported investments in capital and labor for an average term of 57 months, similar to market terms. Worth noting in these operations is the financial additionality to the project for construction and commissioning of a wind farm, due to the lack of financing for projects of this type in the financial market (low capitalization of local banks and exposure constraints of international banks).
- 3.29 Public and fiscal management lost relevance with respect to the previous country strategy, consequently receiving limited support. Having had a much more stable macroeconomic performance than in the preceding period, the country did not in practice prioritize support in this area. However, both the Bank's country strategy and the PNDH stressed the need to support the country in terms of public expenditure efficiency. Furthermore, when having a portfolio focused on infrastructure and social expenditure, spending efficiency issues take on great significance. Despite its own diagnostic assessment and the program profile, the Bank's support in the public and fiscal management area was limited.
- 3.30 In the 2013-2017 period, the Bank approved US\$15.8 million in technical cooperation operations in an attempt to continue the support of public sector management provided in the previous country strategy. As of 2013, there was an undisbursed balance of US\$12.4 million from the previous period. The technical cooperation resources supported the institutional strengthening of various institutions through training, manuals, technical

guidelines, and diagnostic assessments,¹²⁷ resulting in a modest improvement in the effectiveness of public management as a whole. However, the absence of a strategic focus eliminated the possibility of providing further support in facing the challenges identified for the sector (public management).

3.31 Broadband: In line with the government's priorities and capitalizing on the availability of donor resources, the Bank supported the National Broadband Plan to expand the country's digital connectivity; however, regulatory aspects need to be reinforced in order to spur competition. In 2013, the Bank carried out a technical cooperation operation (NI-T1174) to identify the investments and regulatory reforms required to develop a national plan. This operation was followed by the Broadband Program (NI-L1090) for US\$50 million. The program will finance procurement of the optical fiber needed to expand the scope of the existing trunk and last-mile network, review of the regulatory framework, and pilot programs to promote the use of broadband in the health and agricultural sectors. However, delays in the operation have held up the creation of a regulatory framework for broadband network use, which is essential for ensuring accessibility.

¹²⁷ The beneficiaries include the Ministry of Finance and Public Credit (which received support in implementing the Harmonized Tax Law, analyzing fiscal information, improving coverage, implementing a tax culture program, visits by officials to develop PPPs, strengthening the monitoring of IDB projects, and other matters), the National Assembly (through training in performing cost-benefit analyses of the law), the *Contraloría General de la República de Nicaragua* [Office of the Comptroller General of Nicaragua] (through planning, monitoring, and evaluation tools, and drafting of the Institutional Strategic Plan 2016-2020), the National Police (through modernization of its information system), the Central Bank of Nicaragua (through training in collecting statistics and strengthening of statistics systems), and the *Superintendencia de Bancos y Otras Instituciones Financieras* [Office of the Superintendent of Banks and Other Financial institutions] (SIBOIF).



04

Conclusions and Recommendations

A. Conclusions

- 4.1 In the 2013-2017 period, the Bank continued to work closely with the Government of Nicaragua as its main multilateral partner, remaining relevant in the areas of productive infrastructure and social investment with a focus on closing the urban-rural divide. The resources approved under the Bank's operations program for the 2013-2017 period were 45% higher than in the previous period. This took place in a context of work with the Government of Nicaragua, which helped to coordinate the participation of multilateral agencies. In addition, the Bank leveraged its loans with significant bilateral and multilateral cofinancing resources. The program allocated more than 80% of its resources to the electricity, road, and health sectors, in line with the strategy of the Nicaraguan government. Furthermore, the program was relevant because its interventions helped to expand coverage and access to services in rural areas with lower coverage. During the period, the Bank also attracted more than US\$50 million in supplementary investment grants.
- 4.2 The portfolio consisted primarily of sequential investment projects that emphasized civil works, and technical cooperation operations that reinforced execution capacity. The Bank kept the share of PBLs stable, which helped with disbursements. In the investment area, the Bank focused on infrastructure, even in sectors with limited works management capacity (such as agriculture and natural resources, health, and tourism). This turned out to be a key bottleneck in execution, and the Bank responded primarily through ad hoc technical cooperation operations aimed at strengthening execution capacity.
- 4.3 There were significant advances in productive infrastructure in the priority sectors of the country strategy, but the sustainability of the investments continues to be a challenge. The Bank played a central role in the improvement of infrastructure, particularly in the energy sector and with the connectivity of the Pacific-Atlantic corridor. However, long-term sustainability risks persist. For example, the absence of an operating budget jeopardizes the operational road network, as well as maintenance of the water and sanitation works, areas in which the Bank has helped to finance investments. This pattern is repeated with services such as those launched through the health and early childhood programs, which are at risk of being discontinued due to lack of space in the national budget.
- 4.4 The Bank allocated fewer resources to public and fiscal management than in the previous period, although doing otherwise would have been relevant to improving the fiscal space and making program-financed investments sustainable.

Less attention was placed on public administration issues than in the previous country strategy. The Bank approved about US\$16 million in technical cooperation resources, which strengthened the institutional capacity of various government agencies. This stands in contrast to the importance given to these issues in the National Human Development Plan (PNDH), in OVE's country program evaluation with Nicaragua for the period 2008-2012 (document RE-422-3), and in the discussion on key barriers to development in the current country strategy. The foregoing is relevant, since the sustainability of the works and services financed through the program depends on factors that include institutional capacity, expenditure targeting, and adjustments in the sector frameworks.

- 4.5 The Bank's program in the productive sector was relevant because it set in motion major financial and institutional reforms, but these reforms have not yet succeeded in creating a critical mass in sectors with the potential to generate greater value added. Actions in value chains were focused on two PBLs, primarily related to financial and institutional reforms, as well as on isolated operations approved prior to 2013. While the policy conditions of the PBLs constitute important steps toward improving the regulatory environment for doing business and enhancing financial inclusion, a government commitment is needed to develop a critical mass in sectors in which the country could provide greater value added.
- 4.6 The private sector portfolio supported relevant sectors but contracted by 12% and showed limited financial additionality. Thus, it reflected the need to explore potential support through public-private partnerships (PPPs), as had been suggested in the previous country strategy. Direct corporate lending to SMEs and large companies shrank by 45% with respect to the prior period, reflecting access to alternative sources of financing on the part of clients of IDB Invest. In addition, loans channeled through financial intermediaries supported the real sector of the economy and offered similar maturities to those available in the market but promoted financial inclusion by serving small and medium-sized producers. Moreover, IDB Invest performed a thorough analysis of potential opportunities in Nicaragua, concluding that PPP opportunities are available if they are developed in the context of adequate rate structures for the country.

B. Recommendations

- 4.7 In view of the preceding conclusions, OVE recommends that Management should consider a proposal to the country to continue working to lock in the remarkable progress that has

been made in the country's development. It should be noted that the country and the Bank have been working on the five key areas with varying degrees of emphasis and coverage, subject to the recommendations set out below. Therefore, OVE recommends continuing to work on these areas given their importance in a process of balanced IDB Group support to the country's development. In fact, significant strides have been made and, in the judgment of OVE, they should be continued in the Bank's future strategy with Nicaragua. Lastly, whether the IDB Group plays a greater or lesser role in supporting each area will be subject to the country's preference and demand. Consequently, the IDB Group's action plan may only outline its proposals for supporting the country.

4.8 OVE recommends that the IDB Group should offer the country clear continuity of support in five key areas of work. The first two areas of work are aimed at strengthening the project cycle, both at the front end (preinvestment and execution capacity) and at the back end (sustainability). The third recommendation is aimed at restoring the centrality of the dialogue on the efficiency of public expenditure to help the country expand its fiscal space sufficiently to sustain an ambitious investment program. The fourth recommendation is aimed at supporting the country in its long term investment planning process through a territorial approach designed to resolve infrastructure bottlenecks that limit competitiveness. The final recommendation suggests that the IDB Group should redouble its efforts to support the country in promoting competitiveness and value added in key sectors in which it could have comparative advantages.

- **Recommendation 1 – Preinvestment and implementation capacity: Continue to support the country in the stages of preinvestment and capacity-building for the execution of operations.** In view of the challenges evident in the preinvestment and implementation stages, OVE recommends that the IDB Group should support both the preparation of detailed designs for investment projects and capacity-building at the executing agencies. In addition, as part of the project design process, it should evaluate the execution capacity of agencies that are not specialized in the management of civil works.
- **Recommendation 2 – Sustainability of investments: Continue to work with the country to identify and promote mechanisms to improve the sustainability of works and services financed by the IDB Group.** OVE recommends that the loan proposals should identify sustainability risks and thoroughly analyze potential mitigation measures to optimize the continuity of operation and maintenance of program outputs (infrastructure works and services).

- **Recommendation 3 - Fiscal management: Deepen the dialogue and intensify financial support for the government to improve fiscal space, including the efficiency of spending, with a view to optimizing the sustainability of the country's public investment.** OVE recommends that the Bank should propose to the country efforts to tackle the structural elements on both the revenue and fiscal spending sides that limit the country's capacity to meet its public investment challenges. The Bank's support should be aimed at improving the country's fiscal capacity to sustain public investment in the medium and long term. In turn, to guide these reforms, OVE recommends supporting the country in strengthening its fiscal management tools, including its monitoring and evaluation systems for investment projects.
- **Recommendation 4 - Comprehensive planning: Continue to support the country in identifying medium- and long-term investments.** OVE recommends that the IDB Group should continue to support the country in building its medium- and long-term comprehensive planning capacity, including territorial aspects to help prioritize investments in the various types of physical infrastructure and services that can spur the country's development.
- **Recommendation 5 - Competitiveness and value added: Continue the IDB Group's support in developing the country's competitiveness by furthering reforms to improve the business climate and increasing the value added of supply chains in which Nicaragua could have comparative advantages.** OVE recommends that the IDB Group should continue to provide support, acting through its public and private windows, to improve the business climate and expand the supply of production inputs that will enhance value added in sectors in which Nicaragua has comparative advantages. In addition, OVE recommends that IDB Invest should provide support in public-private partnerships.

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